

National Bank of the Republic of Belarus

**Report on the Development of the Republic of Belarus Banking
Sector and Banking Supervision in 2006**

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Introduction

The Report on the Development of the Banking Sector of the Republic of Belarus and Banking Supervision in 2006 (“the Report”)¹ has been prepared with a view to providing information transparency of the Belarusian banks’ performance.

This Report will allow Belarusian and international community (including prospective investors and customers) to get a better idea of the state and main trends of banking sector and banking supervision development in 2006, conditions and major factors affecting the functioning of the domestic banking sector, and the main risks of operation accumulated by the banking sector, as well as methods and ways of mitigating such risks by a supervisory authority.

The main goals of Belarusian banking sector development in 2006 were as follows: to enhance the sector’s stability and performance, to expand its financial potential, to improve the quantity and quality of banking operations and services, to boost national and foreign investors’ and depositors’ confidence in the banks, and to develop competitive advantages.

The attainment of these goals was facilitated by expanding volumes of the banks’ operations, with simultaneous streamlining of the assets and liabilities structure by means of increasing the share of attracted long-term funds; boosting the provision of most up-to-date services; increasing the banks’ capitalization for the purpose of mitigating bank risks; reforming corporate governance; improving risk management; adopting international standards of doing banking business; improving the quality of interaction with customers, and developing new forms of information support of banking services provision.

The Report describes the macroeconomic conditions of banking sector development, reviews the risks of the banks’ operation, analyzes banking sector sustainability and banks’ performance efficiency in 2006, and discloses the main strategic directions of banking sector development in 2007. It also provides an assessment of the progress in bringing prudential requirements and supervisory procedures closer to the internationally recognized standards, the current state of banking supervision and prospects of its improvement.

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1. Development of the Republic of Belarus banking sector

1.1. Banking regulation

In 2006, the Government was consistently pursuing a policy of banking sector development aimed at ensuring stable functioning of the banking sector of the national economy by implementing measures designed to harmonize the interests of the banking sector and other sectors of the economy. This became apparent in the streamlining of the regulatory legal framework in the field of monetary regulation, taxation, and bank supervision.

For the purpose of enhancing the efficiency of the banking sector of the Republic of Belarus, work was in progress in 2006 to devise a program of Belarusian banking sector development for 2006-2010 which sets the goals, tasks, and major directions of banking sector development. Enhancing stability and efficiency of the banking sector of the Republic of Belarus as well as increasing the potential and improving the composition of banking instruments in line with the growing needs of the economy and the households remain the strategic goals of banking sector development.

With the enactment in 2006 of the Law of the Republic of Belarus “On Introducing Modifications and Amendments to the Banking Code of the Republic of Belarus” which became effective on October 27, 2006, the powers of the National Bank in the field of banking supervision expanded significantly which spurred efforts to modernize the methods of and procedures for the supervision process.

Work was carried on in 2006 to bring regulatory legal acts that specify basic provisions governing operation of banks and non-bank financial institutions within the Republic of Belarus in line with the redrafted Banking Code. To this end, the underlying regulatory legal acts in the field of banking supervision were updated; in particular, the following revised documents were adopted—the Instructions on the secure functioning requirements for banks and non-bank financial institutions (approved by Resolution of Board of the National Bank of the Republic of Belarus No. 137 dd. 28.09.2006), the Instructions on procedures for making provision by banks and non-bank financial institutions for potential losses on assets and off-balance operations

(approved by Resolution of Board of the National Bank of the Republic of Belarus No. 138 dd. 28.09.2006), the Instructions on procedures for compiling and filing with the National Bank of prudential reports by banks and non-bank financial institutions (approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 172 dd. 31.10.2006), the Instructions on procedures for the issuance by the National Bank of directions and imposition of sanctions on banks and non-bank financial institutions (approved by Resolution of Board of the National Bank of the Republic of Belarus No. 195 dd. 28.10.2006), the Instructions on procedures for state registration and licensing of banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 175 dd. 28.06.2001 (amended by Resolution of Board of the National Bank of the Republic of Belarus No. 171 dd. 31.10.2006), and others. Besides, a number of new regulatory documents were adopted, including, *inter alia*: the Instructions on the organization of an internal control function at the banks and non-bank financial institutions (approved by Resolution of Board of the National Bank of the Republic of Belarus No. 139 dd. 28.09.2006), the Instructions on the assessment of conformance of candidates for positions of the head and chief accountant of a bank or non-bank financial institution, its branch and deputies thereof to the qualification and business reputation requirements (approved by Resolution of Board of the National Bank of the Republic of Belarus No. 140 dd. 28.09.2006).

1.2. Macroeconomic environment of banking sector development

The macroeconomic situation in 2006 was, on the whole, beneficial for banking sector functioning and was reflected in the following:

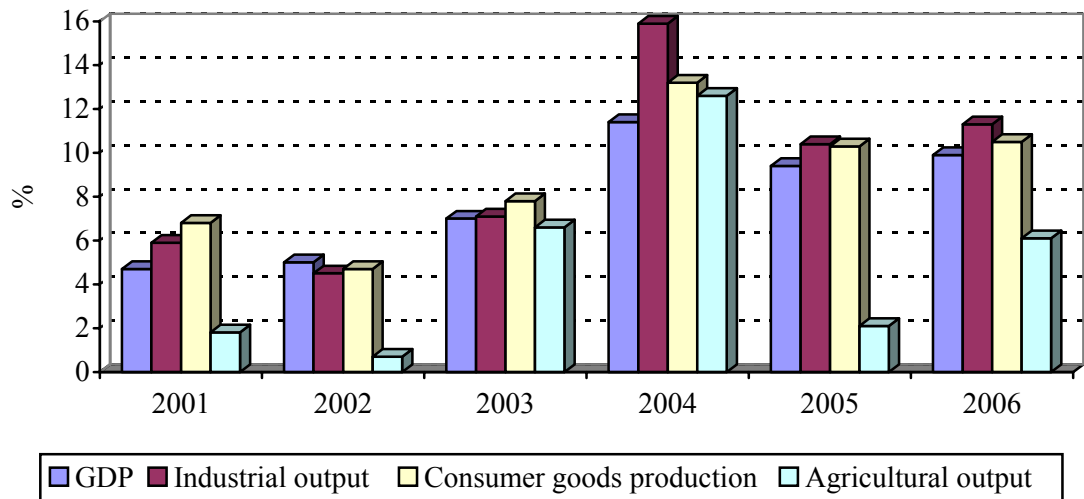
- the rates of economic growth remained high;
- the consolidated budget ran a surplus;
- the financial situation of organizations was characterized mainly by positive dynamics of the majority of indicators;
- the households' real wages, money incomes, and savings continued to rise at a fast rate; and
- inflationary processes continued to grow weaker.

Economic development. In 2006, GDP in current prices amounted to 79.2 trillion Belarusian rubles, a 9.9% increase in comparable prices on the previous year.

The share of GDP in added value of industry was 27.6%, agriculture 7.5%, construction 7.9%, transportation and communication 9.2%, and trade and catering 10.3%.

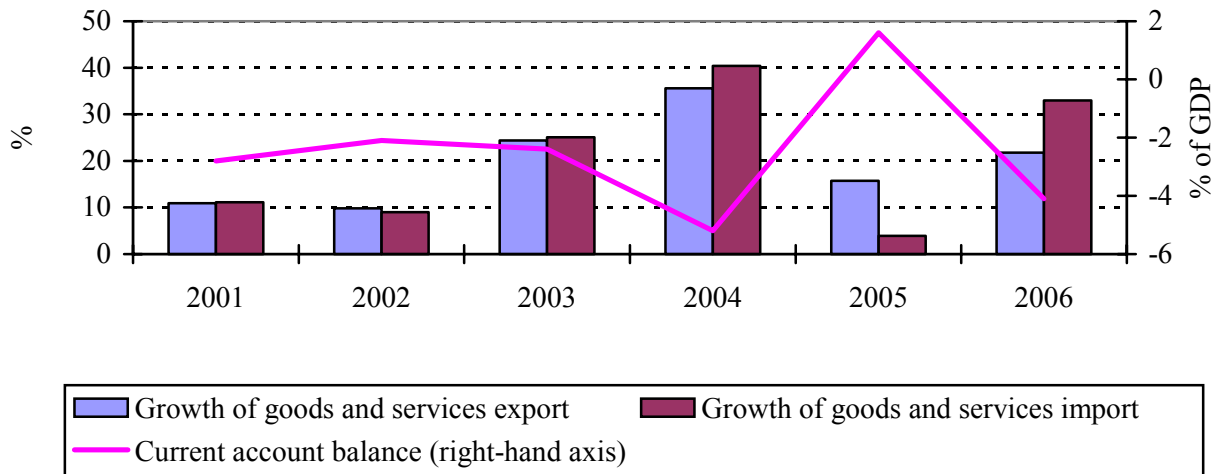
Industrial output grew in comparable prices by 11.3% and consumer goods production by 10.5% (figure 1). Agricultural output grew by 6.1%, including in agricultural organizations and peasant holdings (farms) by 9%.

Figure 1. Economic Growth in the Republic of Belarus



Foreign trade. According to the balance of payments of the Republic of Belarus, export of goods and services in the whole of 2006 amounted to USD22.1 billion and import of goods and services by USD23.7 billion, a 21.8 and 33% increase, respectively, compared with the year before. As a consequence, foreign trade deficit in 2006 stood at USD1.6 billion compared with USD0.3 million in 2005 (figure 2).

The current account deficit was financed chiefly by means of attracting short-term capital (USD721 million), long-term loans (USD464 million), and direct investment (USD351 million).

Figure 2. Individual Indicators of Balance of Payments

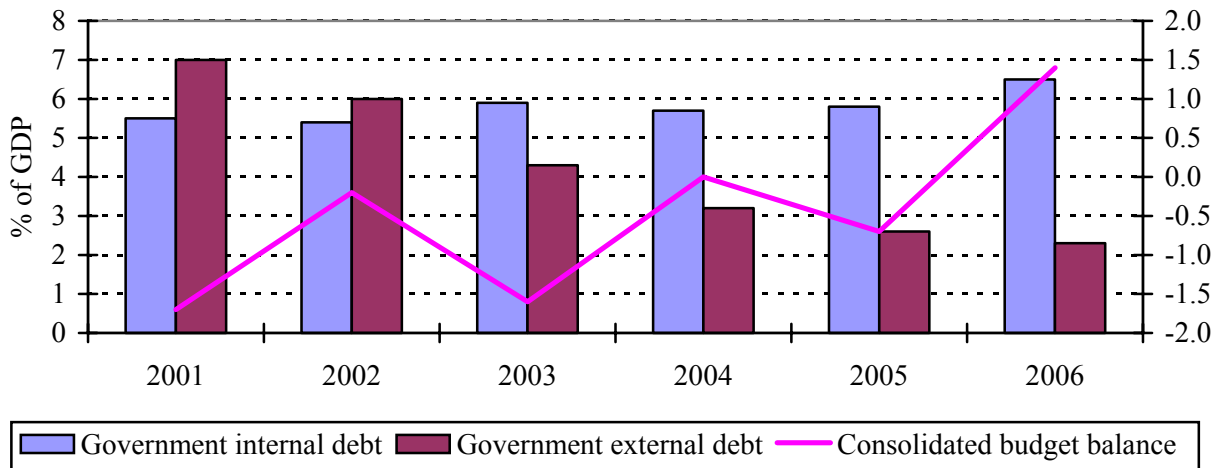
On the whole, the total balance for 2006 ran an insignificant deficit (USD1.4 million), whereas in 2005 it was positive (USD0.5 billion).

Gold and foreign exchange reserves of the Republic of Belarus grew by 6.7%, amounting as at January 1, 2007 to USD1.4 billion, or 0.7 months of import compared with 0.9 months of import as at January 1, 2006.

Public finances. In 2006, budget revenues amounted to 38.4 trillion Belarusian rubles and budget expenses were financed in the amount of 37.3 trillion Belarusian rubles. As a result, consolidated budget surplus was 1.1 trillion Belarusian rubles, or 1.4% of GDP compared with a 0.7% deficit of GDP in 2005 (figure 3).

Government internal debt in 2006 grew by 1.5 trillion Belarusian rubles, or by 40.2%, amounting, as at January 1, 2007, to 5.2 trillion Belarusian rubles (6.5% of GDP). Government external debt (save interest payment) amounted, as at January 1, 2007, to USD838 million (2.3% of GDP), increasing by USD54 million, or by 6.9%, compared with the beginning of 2006.

Financial performance of organizations. In 2006, most major financial indicators of enterprises in the real sector of the economy enjoyed, on the whole, positive dynamics. This was manifest in the growth of real volumes of sales and profit, in an increasing share of proceeds from selling products, goods, works, and services paid for with money, in improving settlements, and in growing profitability of sold products and current ability to pay.

Figure 3. Public Finances Performance

At the same time, certain negative processes emerged in 2006. There is a substantial difference in the financial condition of enterprises in different sectors of the economy and the efficiency of business and economic activities of many enterprises is low, which restricts the growth of efficiency of the economy as a whole.

Proceeds from the sale of products, goods, works, and services of organizations in the whole of 2006 amounted to 153 trillion Belarusian rubles in current prices, a 13.9% increase in real terms (adjusted for the GDP deflator) compared with 2005.

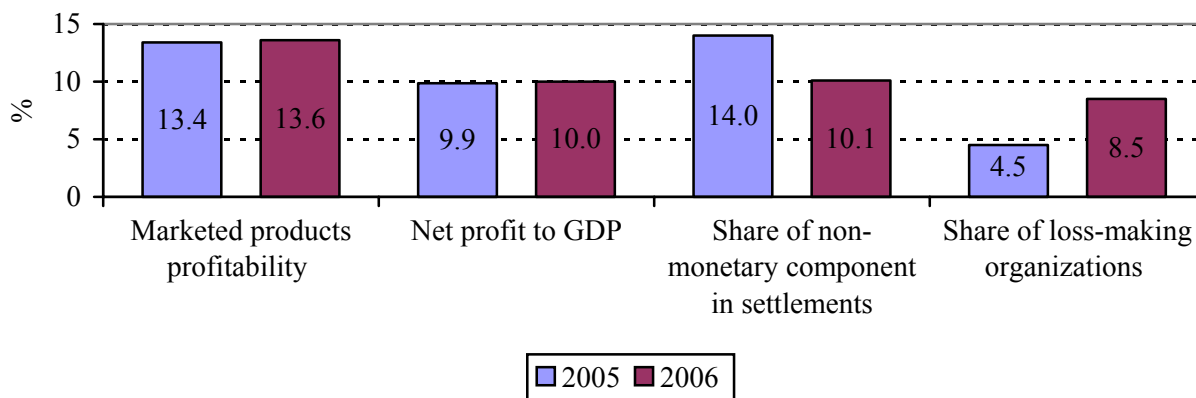
At the same time, demand restrictions relating, above all, to the competitive weakness of a number of goods and the underdeveloped goods distribution system precluded larger volumes of sales of manufactured goods. Finished goods inventories of industrial enterprises in 2006 grew in current prices by 479 billion Belarusian rubles amounting as at January 1, 2007 to 53.4% of the monthly average output compared with 51.9% at the beginning of 2006.

Proceeds from the sale of products, goods, works, and services in 2006 amounted to 12.4 trillion Belarusian rubles, a 12.7% increase in real terms compared with 2005. As a share of GDP they remained at the 2005 level, i.e. 15.6%. Net profit rose by 23.6%, amounting to 7.7 trillion Belarusian rubles (figure 4). Growing real profit from the sale of products and a relative reduction of their production cost resulted in the growth of marketed product profitability in the economy as a whole from 13.4% in 2005 to 13.6% in 2006. At the same time, sales profitability declined by 0.1 percentage points, amounting to 8.1%.

The share of loss-making organizations (as a percentage of the total number of organizations) in 2006 was 8.5%, whilst in 2005 it fell to 4.5%.

In 2006, replacement of non-monetary forms of settlements by monetary ones continued. The share of proceeds paid for with money in the overall volume of paid proceeds increased from 88.7% in 2005 to 93.1% in 2006. Such share increased across all major sectors of the economy.

Figure 4. Financial Performance of Organizations



In 2006, all major industries continued to make headway in the non-payments dynamics which became apparent in declining absolute and relative values of arrears indicators. As at January 1, 2007, overdue accounts receivable decreased by 316 billion Belarusian rubles, or by 7.2%, compared with January 1, 2006, and overdue accounts payable by 366 billion Belarusian rubles and by 9.1%, respectively.

The ratio of overdue accounts receivable to the monthly average proceeds from the sale of products in 2006 reduced from 43.6 to 32.1% and overdue accounts payable from 39.2 to 28.3%. The structure of total arrears improved. The share of overdue accounts receivable in the overall volume dropped by 5.2 percentage points, amounting as at January 1, 2007 to 15.8%, and the share of overdue accounts payable by 7 percentage points and to 19.4%, respectively.

Households' income and expenditure. In 2006, money income of households amounted to 47.4 trillion Belarusian rubles, a 25.5% increase compared with 2005, and by 17.3% in real terms (adjusted for the CPI). The share of the households' money income in GDP amounted to 59.9% compared with 58.1% in the previous year.

The households' per capita money income was 406 thousand Belarusian rubles a month, which is 1.6 times the minimum consumer budget and 2.4 times the subsistence wage.

In 2006, accrued nominal monthly average wages were 591 thousand Belarusian rubles, increasing by 25.8% compared with 2005 and by 17.6% in real terms.

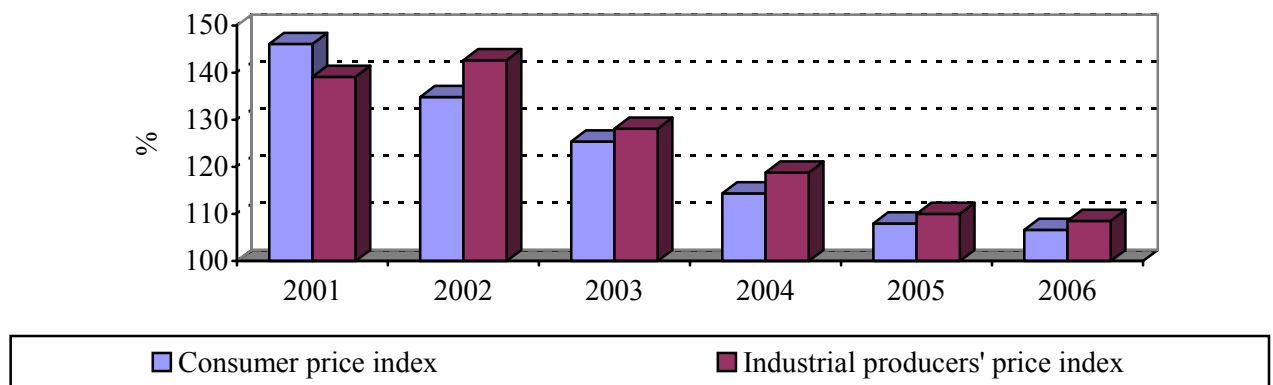
In 2006, the households' cash expenditures and savings amounted to 47 trillion Belarusian rubles. Of these, 38.8 trillion Belarusian rubles (81.8% of the total amount of cash expenditures and savings) was used to buy goods and pay for services, 6 trillion Belarusian rubles (12.7%) to make mandatory payments and voluntary contributions, and 2.2 trillion Belarusian rubles (4.7%) to make deposit and securities savings, including the balance of foreign exchange sale and purchase.

The trend for the households' propensity to save continued in the whole of 2006. The ratio of the households' cash savings growth to cash income (propensity to save) in the same year amounted to 10.1% (8.7% in 2005). At the same time, the share of money used to buy foreign exchange in the structure of cash savings increased from 39.3% in 2005 to 43.3% in 2006.

Inflation. In 2006, inflation in the consumer market stood at 6.6%, or 0.5% in average monthly terms, which is slightly less than a year ago—8 and 0.6% a month, respectively, food prices increasing by 6.5% compared with 8.4% in 2005. Non-foods prices rose by 4.4% (by 3.2% in 2005) and tariffs for paid services by 9.4% (by 11.5% in 2005) (figure 5).

The advance in the total index of consumer prices by 50.9% in 2006 was due to growing food prices (by 57.6% in 2005), by 18.8% due to growing non-food prices (by 10.8% in 2005), and by 30.3% by growing tariffs for paid services (by 31.6% in 2005).

Figure 5. Consolidated Price Indices in the Republic of Belarus



Industrial producers' prices rose in 2006 by 8.5%, including an increase in prices for capital equipment by 8.9%, for intermediate goods by 9.5%, and for consumer goods by 6.5%.

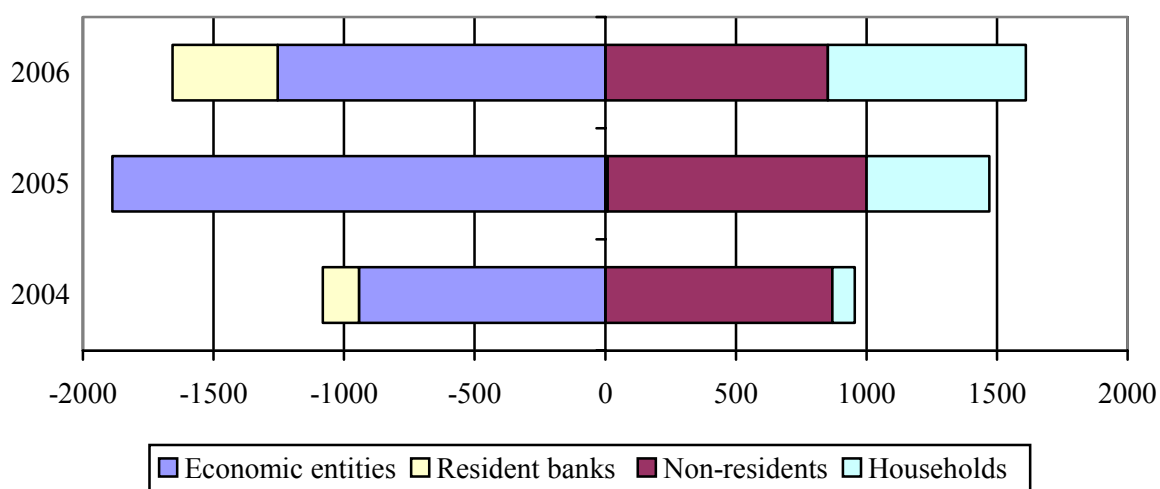
1.3. Key trends in monetary sphere

The following major trends were characteristic of the development of the monetary sphere in the Republic of Belarus in 2006:

- deterioration of situation in the foreign exchange market due to negative trends in the balance of payments and excess of demand for foreign exchange over its supply in the market as a whole;
- insignificant strengthening of the Belarusian ruble against the US dollar and its devaluation vis-a-vis the Russian ruble and euro;
- further deceleration of money supply circulation and continuation of the trend towards a decrease in the dollarization of the economy;
- maintenance of high rates of increase in the households' and organizations' funds in bank accounts, on the one hand, and continued high demand for credits, on the other; and
- declining nominal and real level (adjusted for the CPI) of interest rates on operations in Belarusian rubles.

Foreign exchange market. The worsening balance of payments in 2006 was chiefly responsible for an adverse balance in the foreign exchange market. Where in 2005 the supply of foreign exchange in the foreign exchange market as a whole exceeded demand therefor by USD416 million, 2006 saw a reversal of the situation—demand for foreign exchange exceeded supply thereof by USD46 million (figure 6).

Figure 6. Balance of Operations of Foreign Exchange Market Participants



At the same time, net supply of foreign exchange on the part of economic entities-residents of the Republic of Belarus dropped substantially—from USD1,887 million in 2005 to USD1,254 million in 2006, which was

mainly owing to the fact that the rates of goods and services import were outstripping those of export.

At the same time, net demand for foreign exchange on the part of the general public grew up to USD751 million, whilst in 2005 it amounted to USD471 million. High growth rates of the households' real money income and continued gap between demand for consumer goods and production of competitive domestic products were mainly responsible for growing demand for foreign exchange.

Exchange rate. The Belarusian ruble exchange rate in 2006 was affected by the situation in the domestic foreign exchange market, movement of exchange rates of the major world currencies vis-à-vis one another, and orientation of the National Bank's exchange rate policy towards restricting inflationary processes in the country.

As a result, the Belarusian ruble strengthened against the US dollar by 0.6% and against the Russian ruble and euro by 8.4 and 10.4%, respectively.

Importantly, the real exchange rate of the Belarusian ruble against the Russian ruble and real effective exchange rate were within the range that did not impair price competitiveness of the economy. For example, the index of the Belarusian ruble real exchange rate against the Russian ruble computed on the basis of the CPI in 2006 was below the 2005 level by 6% and the real effective exchange rate by 2.6%.

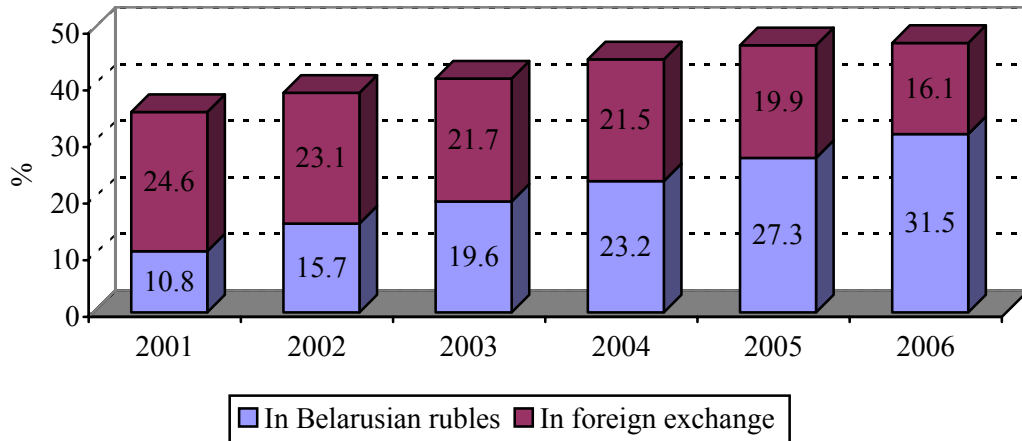
Money supply. Broad money in 2006 grew by 39.3%, including in Belarusian rubles by 44.5%, the figures for 2005 increasing by 42.2% and 59.5%, respectively. As a consequence, the share of the ruble money supply in the total broad money rose by 2.5 percentage points, amounting as at January 1, 2007 to 70.9%, compared with a 7.4 percentage point and 68.4% increase, respectively, in 2005.

At the same time, said change in the money supply in 2006 was accompanied by a further decline in the velocity of money circulation in the economy—the velocity of broad money circulation slowed by 15% (by 9.7% in 2005) and that of the ruble money supply by 21.6% (by 17.1% in 2005).

In the structure of broad money, term deposits denominated in Belarusian rubles were growing most rapidly—from 27.3 to 31.5%. On the whole, despite the declining share of term deposits in foreign exchange by

3.9 percentage points, the share of term monetary aggregates increased to 47.5% (figure 7).

Figure 7. Term Deposits in the Broad Money Structure

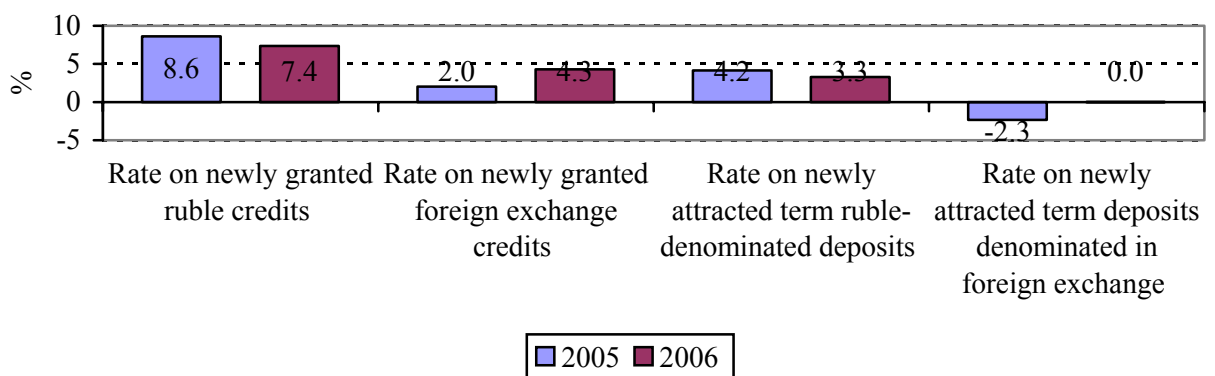


Interest rates. The difference in the interest rate levels in the market of deposits denominated in Belarusian rubles and foreign exchange as well as a continued positive level of interest rates on ruble-denominated deposits had a major impact on changes in the broad money structure.

In 2006, on average, the interest rate on newly attracted ruble deposits was 9.3% per annum compared with 11.9% in 2005, declining by 2.6 percentage points. In real terms in the whole of 2006, it was 3.3% per annum compared with 4.2% per annum in 2005, decreasing by 0.9 percentage points (figure 8).

The interest rate on newly attracted term deposits in foreign exchange in 2006 was, on average, 6.6% (6.4% per annum in 2005) and in real terms 0% per annum (minus 2.3% per annum in 2005).

Figure 8. Average Interest Rates in Real Terms

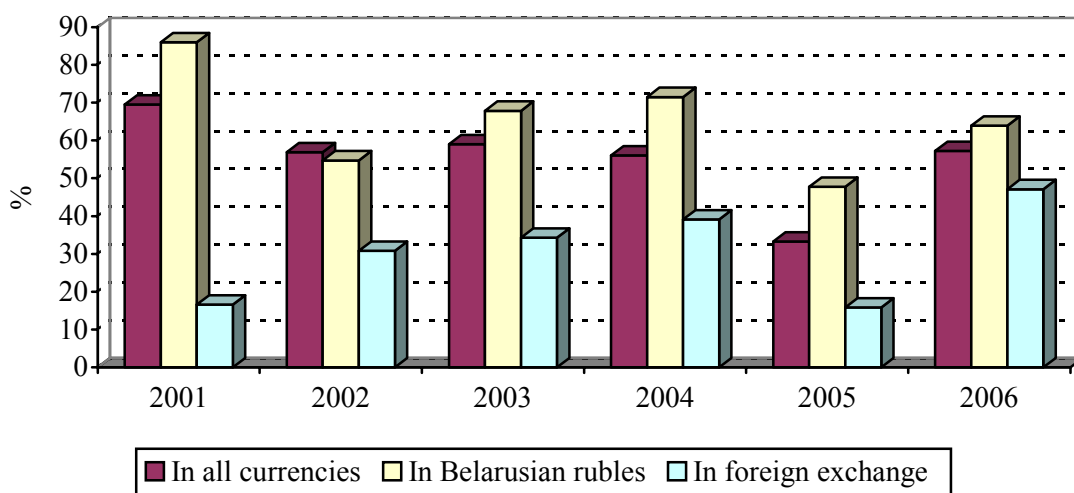


Similar changes occurred in the nominal interest rates in the credit market as well. The average interest rate on the banks' new credits

denominated in Belarusian rubles in 2006 was 13.4% per annum, a 3 percentage point decrease on the previous year, declining in real terms from 8.6 to 7.4% per annum. The average rate on new credits denominated in foreign exchange was 10.9% per annum (10.8% in 2005), or 4.3% per annum in real terms (2% per annum in 2005).

Credit arrears. 2006 was characterized by a growing demand for credits on the part of non-financial institutions and households. There was a substantial increase in the banks' claims on the economy in 2006 compared with 2005—57.2 and 33.3%, respectively. Financing in Belarusian rubles was growing most vigorously—by 63.9%, with claims in foreign exchange amounting to 47.1% (figure 9).

Figure 9. Growth of Banks' Claims on the Economy



The outstripping growth of household lending with respect to the growth of non-financial institutions' credit arrears—by 66.6% and 54.4%, respectively,—which has been continuing in recent years gave rise to an increase in the share of the banks' credits to natural persons. As at the end of 2006, they accounted for 27.8% versus 26.3% by the end of 2005.

1.4. Institutional characteristics of the banking sector

1.4.1. Quantitative and structural characteristics of the banking sector

The banking sector of the Republic of Belarus plays a dominant role in the market of financial services. It is represented by the banks engaging in a wide range of banking operations intended to provide services to enterprises and households.

As at January 1, 2007, the banking sector of the Republic of Belarus comprised 30 operating banks and 421 branches. In 2006, 19 branches were closed, the main causes being the streamlining and closure of loss-making branches and adoption of sophisticated technologies for managing the area structures of the banks.

The shrinking of branches was accompanied by the growth of other organizational units of the banks, such as cash settlement centers, banking services centers, exchange offices, etc.

The distinctive features of the banks' institutional development in 2006 were:

- a decline in the share of non-residents of the Republic of Belarus (hereinafter—"nonresidents") in the aggregate authorized capital of the banks from 9.3 to 7.8% and a simultaneous decline in the share of the banks with prevailing non-residents' capital in the assets of the banking sector from 16.2 to 14.7%, and in the aggregate regulatory capital from 15.6 to 13.7%, the number of banks with prevailing foreign capital remaining unchanged (18 banks);

- a decline in the share of private ownership of residents of the Republic of Belarus (hereinafter—"residents") in the aggregate authorized capital of the banking sector from 5.4 to 4.2% and a simultaneous slight increase in the share of banks with prevailing private ownership of residents in the authorized capital in the assets of the banking sector from 6.28 to 6.3%, and in the aggregate regulatory capital from 5.52 to 5.68%, as well as an increase in the number of such banks from six to seven; and

- an increase in the share of banks with prevailing participation in the authorized capital of public authorities and state entities in the assets of the banking sector from 77.55 to 79%, in the aggregate regulatory capital from 78.84 to 80.6%, with the number of such banks decreasing from six to five and the share of public authorities and state entities in the aggregate authorized capital of the banking sector increasing by 2.6 percentage points (up to 87.9%).

1.4.2. Structure of banks' authorized capital

In 2006, the banks' aggregate authorized capital increased by 796.5 billion Belarusian rubles, amounting as at January 1, 2007 to 3,738.0 billion Belarusian rubles, or the equivalent of USD1.75 billion. As at January 1, 2007, the concentration of the authorized capital in four banks in which the share of the Ministry of Economy of the Republic of Belarus exceeded 50% of the authorized capital amounted to 86.8%.

1.4.3. State participation in the banking sector

Participation of public authorities and state entities in the authorized capital of the Belarusian banks is determined by strategic directions of the country's economic development and by the tasks of lending to the state development programs faced by the banking sector of the country's economy.

As at January 1, 2007, the Ministry of Economy of the Republic of Belarus participated in the authorized capital of 10 banks in the aggregate amount of 2,708.7 billion Belarusian rubles (72.5% of the banking sector's authorized capital). The share of the Ministry of Economy of the Republic of Belarus in four banks exceeded 50% of their authorized capital: JSSB "Belarusbank", OJSC "Belagroprombank", OJSC "Belpromstroibank", and OJSC "Belinvestbank" (hereinafter – "state banks").

In accordance with the edicts of the President of the Republic of Belarus and resolutions of the Council of Ministers of the Republic of Belarus, in 2006, the state invested 754.4 billion Belarusian rubles in the banks' authorized capital.

Retaining the controlling interest in the above-mentioned four banks is mandated by the need to perform in a qualitative manner their functions pertaining to the provision of services to the general public, such as the protection of deposits, extension of credits, and provision of a wide range of other banking services, the provision of financial support to industrial and agro-industrial complex enterprises, expansion of investment activity, as well as to the tackling of other priority tasks under the state social and economic development programs.

1.4.4. Foreign capital participation in the banking sector

The investment climate and the policy of attraction of foreign investments into the country's economy are specified in the Investment Code of the Republic of Belarus, the National Program for Attracting Investments into the Economy of the Republic of Belarus for a Period Until 2010, and the policy documents related to the development of the banking sector of the country's economy that provide for the implementation of a complex of measures designed to improve ownership relations legislation, tax and customs legislation, investment and entrepreneurial activities, development of the free economic zones, establishment of an investment infrastructure, and provision of a number of preferences for foreign investors.

As at January 1, 2007, foreign capital participated in the authorized capital of 26 banks out of 30 operating banks. The share of non-residents in the aggregate authorized capital of the Belarusian banks amounted to 7.84% as at January 1, 2007, the share of the Russian capital in the banks' authorized capital being 2.41%. Capital from Switzerland, Austria, USA, Ireland, countries of the British Commonwealth, Cyprus, Latvia, Lithuania, Kazakhstan, Libya, and other countries also participates in the authorized capital of the Belarusian banks.

As at January 1, 2007, there were 11 representative offices of foreign banks in the Republic of Belarus: 4 Latvian, 2 Russian, 1 German, 1 Lithuanian, 1 Kazakh, 1 Ukrainian, and 1 representative office of the Interstate Bank.

1.4.5. Functioning of institutional entities promoting banking sector stability

Banking legislation, including the Banking Code of the Republic of Belarus, provides for non-bank financial institutions, which constitute an alternative to the banks, to act, along with the latter, as parties to legal banking relationships. The Banking Code of the Republic of Belarus enshrines the status of such institutions and lays a legal groundwork for their operation and regulation on the part of the National Bank. The National Bank has put in place an adequate regulatory legal framework for the functioning of financial and other institutions performing alternative services.

In line with the Banking Code of the Republic of Belarus for the purpose of guaranteeing the repayment of the funds of natural persons attracted by the banks, different forms of guarantees can be devised and applied in the country.

The requirement which stipulated that the safety and repayment of natural persons' deposits with the banks founded by the state and the banks in which the state owns more than 50% of the voting shares shall be guaranteed by the state in the manner provided by legislation of the Republic of Belarus was excluded from the redrafted Banking Code of the Republic of Belarus.

At present, a system of guarantees is in place which is governed by the regulatory acts of the National Bank of the Republic of Belarus and includes monthly non-repayable contributions of all the banks licensed to attract

deposits from natural persons that are accumulated at the National Bank free of charge.

Moreover, Decree of the President of the Republic of Belarus No. 4 “On Guaranteeing the Safety of Funds of Natural Persons in Foreign Exchange in the Accounts and Deposits with the Banks of the Republic of Belarus” dated April 20, 1998 (hereinafter – “Decree No. 4”) stipulates that the state guarantees absolute safety of natural persons’ funds in foreign exchange in the accounts and deposits with the banks authorized to serve the government programs, i.e. JSSB “Belarusbank”, OJSC “Belagroprombank”, OJSC “Belpromstroibank”, OJSC “Belinvestbank”, OJSC “Belvnesheconombank”, and “Priorbank” OJSC. The repayment of such funds is guaranteed, including accrued interest thereon, in the currency of the account or deposit, on depositors’ first demand.

The repayment of funds attracted by the banks from natural persons in Belarusian rubles and foreign exchange (except for funds in foreign exchange placed with the banks designated by Decree No. 4) is guaranteed by the Rules of guaranteeing the repayment of funds attracted by the banks from natural persons approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 75 dated March 29, 2001. According to these Rules, money from the guarantee fund is used to repay to natural persons funds deposited with the banks in cases where the banks are unable to meet their obligations to natural persons on their own if a bank goes bust. The maximum amount of funds of a natural person in accounts and deposits with one bank, irrespective of the number of types of accounts and deposits of a given person, subject to repayment at the expense of funds of the guarantee fund in case of bankruptcy, is set in the amount equivalent to USD1,000.

The Rules guaranteeing the fulfillment of obligations to repay to natural persons funds in foreign exchange in accounts and deposits with the authorized banks of the Republic of Belarus, approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 33.14 on December 27, 2000, determine the sources for meeting obligations to repay, in full, to natural persons on their first demand funds in foreign exchange in accounts and deposits with the authorized banks designated by the above Decree of the President of the Republic of Belarus and prescribe procedures for the National Bank to ensure compliance therewith.

The Belarusian Banks Association has been successfully functioning in the Republic of Belarus. This is a non-government non-profit organization

incorporating banks and other institutions whose operation is associated with the functioning of the monetary system.

The Association participates in the development and implementation of monetary policy, is directly involved in drafting regulatory legal acts, works out proposals on bank regulation and files them with competent public authorities, arranges and holds symposiums, conferences, seminars, exhibitions, and other events relating to monetary policy and banking, assists in establishing and developing cooperation between the Belarusian banks and foreign financial institutions, and provides members of the Association with legal, organizational, advisory, and other assistance.

For the purpose of reducing credit risks it was decided to establish a credit bureau in the Republic of Belarus. The working group established under the National Bank of the Republic of Belarus developed the concept of the Law of the Republic of Belarus "On Credit Bureau". A system of reception and submission of information on the credits granted in the amount which is not less than the equivalent of USD10,000 which has been established at the Specialized Department of the National Bank in accordance with the Instructions on the Procedures for Reception, Creation, Processing, Storage, and Communication by the National Bank of the Republic of Belarus of Information on Credit Agreements approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 196 dated November 28, 2006 shall be in force until the enactment of the said Law.

1.5. Assets and liabilities structure

2006 saw the boosting of confidence in the banking sector on the part of creditors and depositors which showed up in the growth of the banks' financial potential. The amount of liabilities of the banking sector² in the period under review increased from 20,519.8 billion Belarusian rubles to 29,049.6 billion Belarusian rubles, or by 41,6%.

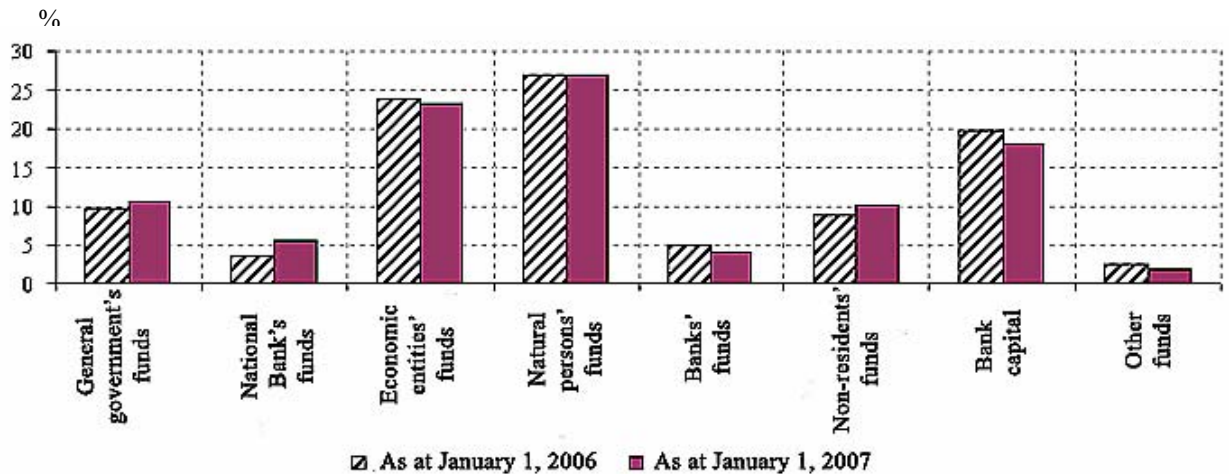
The main source of resource base expansion were funds attracted from economic entities and natural persons which accounted for 48.7% of the total growth of the banking sector's liabilities.

As at January 1, 2007, funds of natural persons amounted to 7,816.8 billion Belarusian rubles, or 26.9% of the banking sector's liabilities (figure 10).

² Including banks in the process of liquidation.

Most vigorous growth was observed in deposits attracted from natural persons in the national currency. While the total deposits of the natural persons' grew by 41.7%, deposits in Belarusian rubles increased by 45.8%, whereas in foreign exchange by only 33.4%.

Figure 10. Structure of Banks' Liabilities in 2006



Ruble-denominated deposits, whose share amounted to 68.3% as at January 1, 2007, prevail in the structure of the households' deposits.

JSSB "Belarusbank" dominates the private deposits market—it has amassed 61.4% of the total amount of the households' deposits in the banking sector. Overall, state banks of the Republic of Belarus account for 87.8% of the total amount of natural persons' deposits with the Belarusian banks.

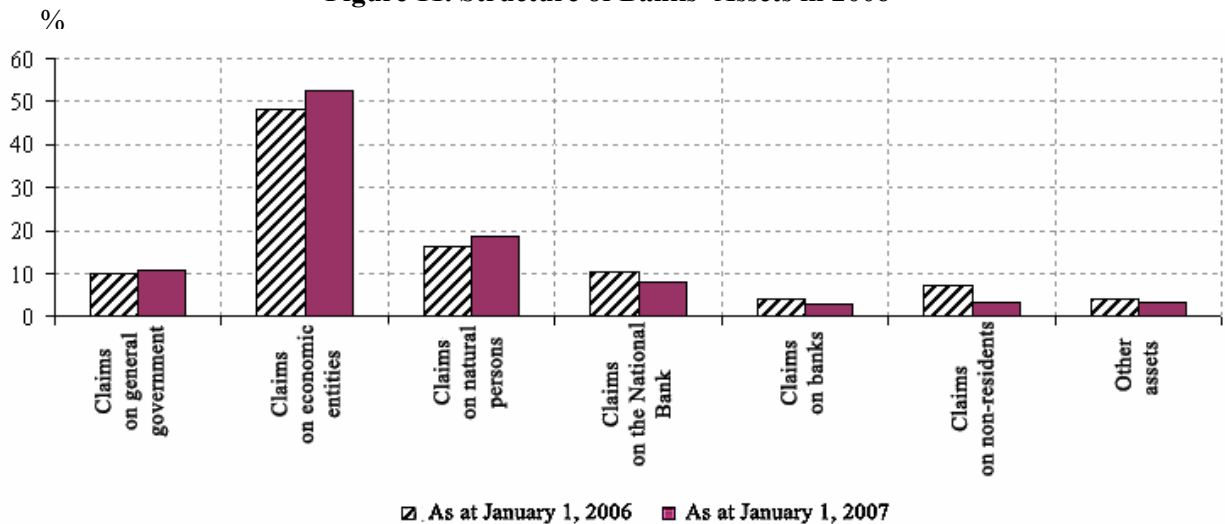
The structure of deposits by currency is not homogeneous—ruble-denominated deposits with the state banks account for 73.1% and foreign exchange deposits for 26.9%, in the remaining banks the ratio is 29.4 to 70.6%, respectively, i.e. the share of foreign exchange deposits with non-state banks prevails.

The second important source of resource base expansion were funds of the economic entities—non-bank financial, profit, and non-profit institutions, and independent entrepreneurs. In 2006, their share grew by 38%, amounting, as at January 1, 2007, to 6,740.5 billion Belarusian rubles. The share of the economic entities in the aggregate liabilities of the banking sector accounted for 23.2%.

In the structure of attracted resources in the period under review funds attracted from non-residents increased from 1,798.4 billion Belarusian rubles to 2,947.3 billion Belarusian rubles, or by 63.9%.

Growing volumes of credit operations of the banks is the main factor responsible for the growth of the assets of the banking sector (figure 11).

Figure 11. Structure of Banks' Assets in 2006



In the structure of the assets of the banking sector the funds placed with residents prevail. In 2006, said funds grew by 8,953.3 billion Belarusian rubles, or by 49.3%, and amounted to 27,124.9 billion Belarusian rubles as at January 1, 2007. Their share in the banks' aggregate assets accounts for 93.4%.

Claims on the organs of state administration increased by 1,109.9 billion Belarusian rubles, or by 55.1%, and amounted to 3,124.3 billion Belarusian rubles as at January 1, 2007. The share of claims on the organs of state administration in the bank's aggregate assets accounts for 10.8%.

The banks' claims on the economy (namely, on the economic entities and natural persons) increased by 7,564.1 billion Belarusian rubles, or by 57.2%, and amounted to 20,783.0 billion Belarusian rubles as at January 1, 2007. The share of claims on the economy increased from 64.4 to 71.5%.

As at January 1, 2007, the clients' and banks' arrears of credits and other asset operations amounted to 22,271.5 billion Belarusian rubles. In 2006, their share in the aggregate assets of the operating banks increased from 70.7 to 76.7%.

In 2006, claims on the National Bank increased by 244.8 billion Belarusian rubles, or by 11.6%, and amounted to 2,346.1 billion Belarusian rubles as at January 1, 2007. Claims on the banks experienced a slight growth—by 34.5 billion Belarusian rubles, or by 4.1%, amounting as at January 1, 2007 to 871.6 billion Belarusian rubles. As at January 1, 2007, the share of claims on the National Bank and banks in the banks' total assets amounted to 8.1 and 3.0%, respectively.

In 2006, funds placed with non-residents of the Republic of Belarus declined by 556.9 billion Belarusian rubles and amounted, as at January 1, 2007, to 918.3 billion Belarusian rubles. As at January 1, 2007, their share in the banks' aggregate assets accounted for 3.2%.

1.6. Efficiency of banking sector performance

1.6.1. Financial result

In 2006, the trend towards increasing the efficiency of the banking sector continued. The banking sector's aggregate profit in 2006 amounted to 411.2 billion Belarusian rubles, a 1.9 times increase on the year earlier. All banks operated at a profit, excepting three banks whose total losses ran into 19.3 billion Belarusian rubles. As at January 1, 2007, the share of assets of those banks in the total amount of the banking sector's assets accounted for 0.2%.

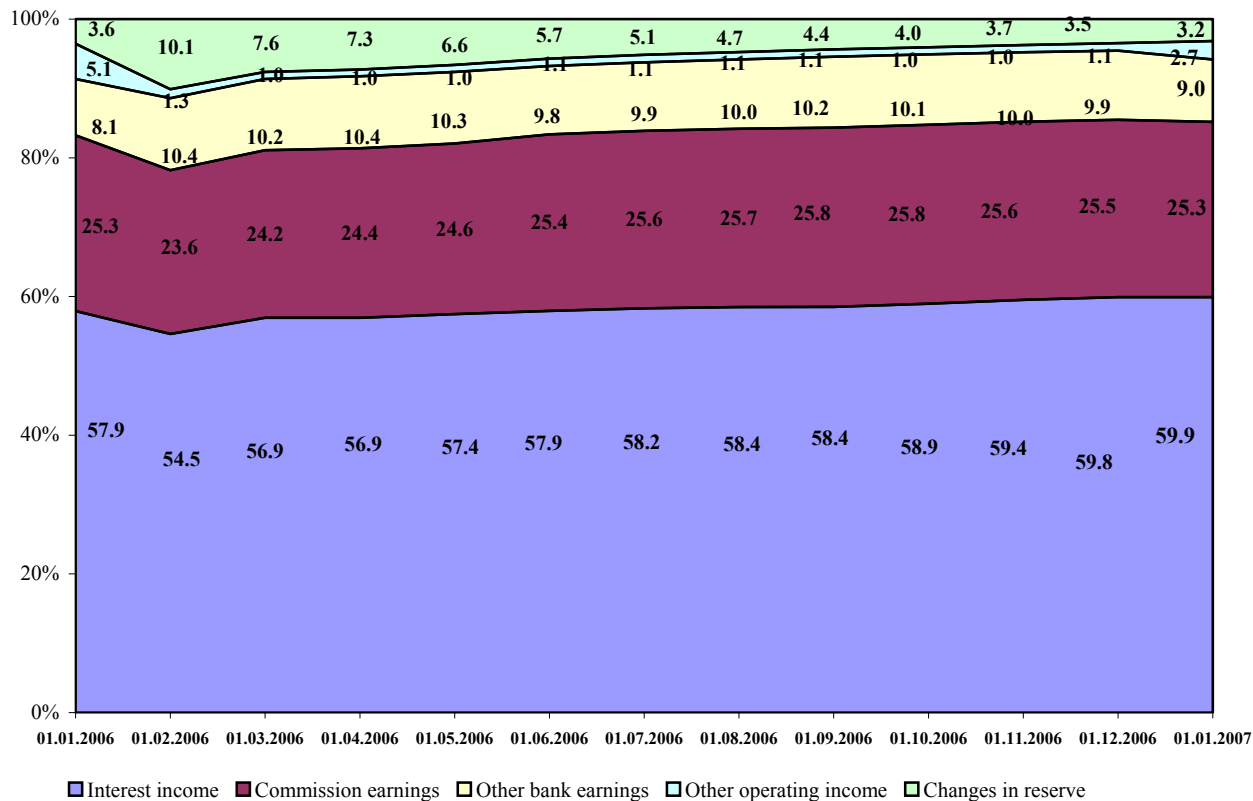
The main factors responsible for the profit growth were the reduction of the tax burden on the banks due to the fact that the banks started to pay profit tax instead of paying income tax, as well as the growth of the assets operations, above all, those related to the issuance of credits to legal and natural persons (in 2006 the banks' claims on the economy grew by 57.2%).

1.6.2. Income and expenditure structure

Macroeconomic environment of functioning and development of the Belarusian banking sector was responsible for continued reduction of interest rates by the banks with a view to facilitating the accessibility of the banking services.

On the whole, the Belarusian banking system in 2006 did not experience sharp movements in the income and expenditure structure (figures 12, 13).

Figure 12. Income Structure of the Banking Sector, 2006

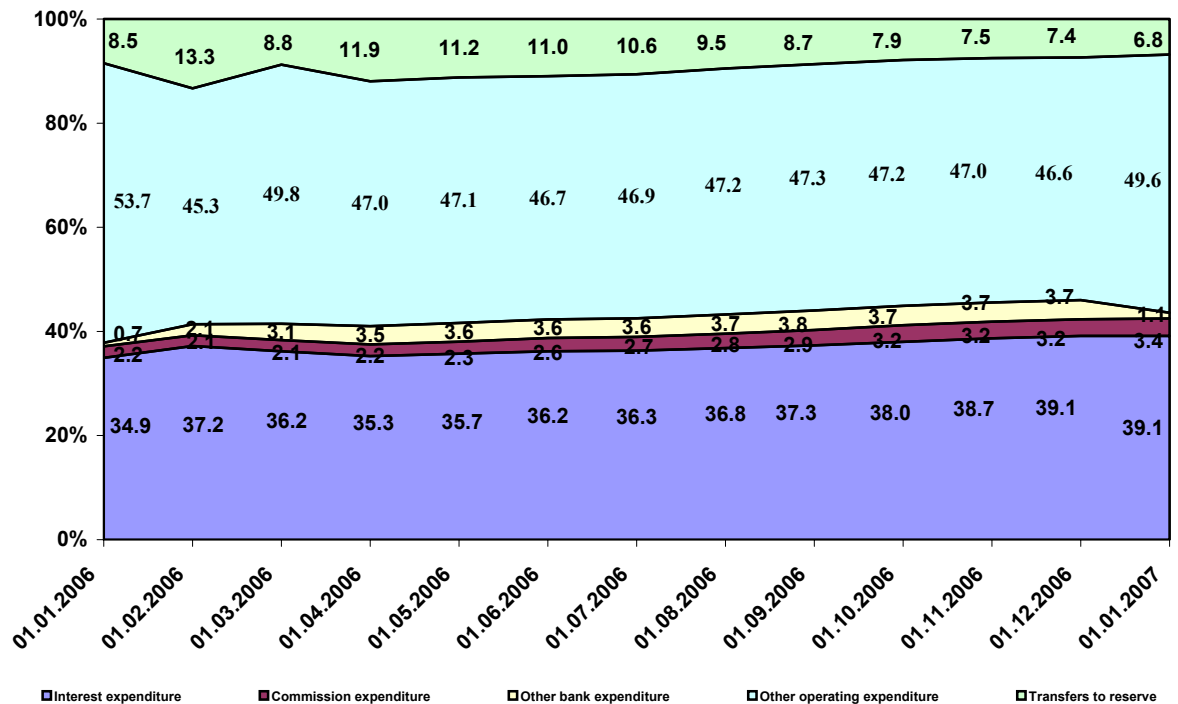


In the income structure, a slight growth—from 57.9% as at January 1, 2006 to 59.9% as at January 1, 2007—was observed in the share of interest income, as well as in the share of other bank income (income from the securities and foreign exchange markets) from 8.1 to 9.0%, with a simultaneous decline in the share of other operating income from 5.1 to 2.7%.

The share of interest expenditure in the banks' expenditures increased in 2006 from 34.9 to 39.1%. The share of operating expenditure fluctuated between 45 and 50%, amounting as at January 1, 2007 to 49.6% of all the expenditure.

In 2006, the profit of the banking sector increased substantially—from 17.9 billion Belarusian rubles per month on average in 2005 to 34.3 billion Belarusian rubles per month on average in 2006—owing to the changes in the taxation scheme of the banking activity by bringing tax legislation norms in the banking industry in line with those of the non-financial sector, as well as to a significant increase in the volume of the banks' assets operations.

Figure 13. Expenditure Structure of the Banking Sector, 2006



1.6.3. Profitability

By the end of 2006 profitability indicators of the banking sector were as follows:

- profit to assets–1.7% (a 0.45 percentage point drop on the year earlier); and
- profit to regulatory capital–9.55% (a 2.8 percentage point increase).

One of the key factors responsible for low-level profitability of the banking sector is an extensive involvement of the biggest banks in the implementation of major social and economic programs, such as soft lending to housing construction, agro-industrial sector of the economy, etc. For example, the return on capital of state banks in 2006 amounted to 8.12%, the return on assets to 1.47%, whereas in the rest of the banks it accounted for 14.45 and 2.41%, respectively.

Changing taxation schemes had an appreciable effect on the improvement of the efficiency of banking sector performance. Beginning in 2006, tax legislation requirements in the banking industry have been brought in line with those of the non-financial sector. This allowed the banks to retain more funds for improving the banking business processes and mastering advanced technologies.

1.6.4. Factors deterring economic efficiency of the banking sector

At present, in spite of the dynamic development of the economy, there are certain unresolved problems deterring the efficiency of the banking sector in terms of both enhancing its functional potential with respect to the country's economy and improving financial results.

The key macroeconomic factors that adversely affect the functioning of the banking sector are:

- inadequate efficiency of public production due to its low technological level;
- high materials and power consumption of the production, its strong reliance on the trends in the prices for imported fuel and energy resources and raw materials which has an adverse impact on the country's balance of payments;
- continued high tax burden in the country;
- strained financial condition of certain enterprises which gives rise to high credit risks; and
- inadequate innovative activity and lack of an efficient mechanism for transferring new knowledge and technologies from abroad, including by means of attracting foreign investments.

There are quite a number of problems arising from the fact that the underlying legislative rules, including legislation governing collateral and mortgage, have not been developed and the financial market infrastructure, including institutions of long-term savings and securities market, is immature.

Problems inherent in the banking sector as a segment of the financial market are as follows:

- a small share of private capital in the banks' authorized capital that restrains the level of competition, as well as the efficiency of the market mechanisms in organizing the functioning of the banking sector and the level of its integration prospects;
- low efficiency of certain segments of banking business which is associated with the implementation by the banks of government programs and free settlement and cash servicing of budgetary operations along with an inadequate level of budgetary reimbursement of banks' losses due to the provision of soft loans and preferential services;

- high lending risks related to the inadequate financial soundness of individual counterparties that obtain credits according to the decisions of the organs of state administration;
- inadequate provision of the banking sector with long-term resources and immature financial institutions of long-term savings;
- an immature corporate securities and derivatives market that restrains the attraction of investments to the banking sector and is responsible for inadequate development of the instruments designed to manage the banks' liquidity;
- a low level of profitability, mainly of the large banks whose controlling interest is owned by the state, adversely affecting the banks' prospects for capitalization at the expense of the internal sources; and
- a relatively high level of dollarization of the resource base and, accordingly, of the banks' credit investments that results in the transformation of foreign exchange risks into credit risks.

Tackling problems related to the impact of the above-mentioned factors will, in many respects, be assured by intensifying efforts of the organs of state administration designed to further improve economic and social policies, including maintenance of macroeconomic stability in the country, rehabilitation of enterprises of the real sector of the economy, raising the households' real income, development of the financial market infrastructure, and elaboration of legislative acts facilitating the development of fair competition, expanding the list of the offered services, and attraction of foreign investments into the country.

Corresponding activities are stipulated in the approved Program of Social and Economic Development of the Republic of Belarus for 2006-2010 and the Program of Belarusian Banking Sector Development for 2006-2010.

1.7. Banks' compliance with the requirements of secure and liquid functioning

The National Bank regulates banking activity to ensure its secure and liquid functioning as well as supervision over such activity and requires the banks to have in place adequate procedures for managing risks in order to identify, assess, monitor, and control them in a timely fashion. In line with the Banking Code of the Republic of Belarus as well as pursuant to the recommendations of the Basel Committee on Banking Supervision in order to maintain stability and sustainability of the banking sector of the Republic of Belarus, the National Bank has set forth prudential regulations for the banks. The methodology for calculating these regulations is provided in the

Instructions on Prudential Regulations for Banks and Non-bank Financial Institutions approved by Resolution of the Board of the National Bank No. 92 dated June 28, 2004 (since January 1, 2007, the Instructions “On Requirements of Secure Functioning for Banks and Non-bank Financial Institutions” approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 137 dated September 28, 2006 which are the revised Instructions No. 92 have been in force).

In 2006, the prudential regulations set forth by the National Bank for the Belarusian banks were basically complied with:

- as at January 1, 2007, capital adequacy in the banking sector amounted to 24.4%, exceeding more than 3 times the required level (8%). In the year under account, the actual value of this indicator exceeded 20%; one bank failed to comply from March 1, 2006 to January 1, 2007 (at present, this bank is in the process of liquidation).

On the whole, the year under account saw compliance with all (four) indicators characterizing banking sector liquidity:

- instantaneous liquidity (ratio of assets on demand to liabilities on demand and with overdue maturities);
- current liquidity (ratio of current assets to current liabilities);
- short-term liquidity (ratio of assets with maturities of up to 12 months and obligations with maturities of up to 12 months); and
- ratio of liquid assets to total assets.

The number of violations of the “Maximum amount of risk per client (a group of connected clients)” requirement (prescribed in the amount not to exceed 25% of a bank’s regulatory capital) in 2006 dropped from eight (in four banks) as at January 1, 2006 to seven (in six banks) as at January 1, 2007.

All banks complied with the “Maximum amount of major risks” requirement (prescribed in the amount not to exceed 600% of a bank’s regulatory capital).

In 2006, one bank violated the “Maximum amount of risk per insider” requirement (prescribed in the amount not to exceed 15% of a bank’s regulatory capital for insiders-legal persons and 2% for insiders-natural persons).

Seven banks violated the open currency position requirements in December 2006; six in April; four in March, June and October; three in January, February, May and July; and two banks in the rest of the months.

1.8. Banking sector development in 2007

In 2007, the development of the banking sector will aim to enhance its sustainability and effectiveness, to strengthen Belarusian banks' competitiveness, to expand the scope and improve the quality of their cooperation with the households and organizations representing the non-financial sector of the economy.

With a view to tackling the above-mentioned tasks the National Bank and the Government will undertake coordinated measures and implement balanced and consistent policy in the development of the banking sector by means of:

- improving the efficiency of banking regulation and supervision;
- developing the institutional structure of the banking sector and creating a fair competition environment; and
- providing favorable conditions for the banks to participate in the financial intermediation as well as taking into account the interests of the banking sector and other sectors of the economy on the basis of assuring mutual economic benefits and systemic stability.

In 2007, the banks' activities will be geared to strict implementation of the 2007 Monetary Policy Guidelines, which stipulate to achieve:

- resource base growth by 20-24%;
- regulatory capital growth by 18-19%;
- return on regulatory capital of no less than 8%;
- the share of problem debts in the clients' and banks' debts on credit operations not exceeding 2.0%;
- the share of problem assets in the assets subject to credit risk not exceeding 4.0%; and
- a 1.7-2 trillion Belarusian rubles increase in the natural persons' deposits with the banks.

Profit and investments in the banks' authorized capital shall be the primary sources of regulatory capital growth, with the share of profit as a source of the regulatory capital creation increasing. The stipulated growth of the banks' regulatory capital shall facilitate the maintenance of the required

level of capital adequacy to cover the risks and assure secure functioning of the banks, the rates of lending to the non-financial sector of the economy being relatively high.

With a view to reimbursing the banking sector's costs resulting from the participation of individual banks in the implementation of the government programs and measures, the Government will provide state support in the amount stipulated in the Law of the Republic of Belarus "On the Republic of Belarus Budget for 2007".

For the purpose of improving the quality of management of the banks and investment attractiveness of their business, as well as enhancing the transparency of the accounting and reporting information, the work related to the implementation of the International Accounting Standards in the banking sector will be continued in 2007 by means of improving the national standards, rules and principles aimed at establishing reliable accounting and reporting, and toughening the requirements to the volume, quality, and frequency of the information subject to publication.

Besides, the National Bank, authorized governing bodies, and executive bodies of the banks will focus on improving the system of managing risks that occur in the course of the banks' operation and enhancing the efficiency of the internal control system at the banks.

2. Banking sector sustainability

In 2006, the dynamic development of the banking sector continued, which was manifest in the expansion of the scope of its interaction with non-financial institutions and households, in the intensification of banking activity, and in a gradual build-up of the banks' financial potential.

Most of the indicators characterizing the banks' financial condition bear witness to a rather stable performance of the banking sector in 2006. At the same time, the dynamics of individual indicators that may potentially threaten future sustainability of the banking sector experiences some adverse effects.

2006 saw a substantial rise in the rates of the banks' credit portfolio build-up, which created prerequisites for increasing their vulnerability to the materialization of credit risks, especially taking into account the financial

condition of a significant number of the borrowers which is not stable enough.

The inconsistency between the banks' assets and liabilities operations in the time structure continued to increase in 2006. The rapid growth of long-term lending along with the absence of an adequate volume of long-term resources was one of the factors responsible for declining liquidity in the banking sector.

In 2006, the banking sector became more susceptible to credit risk (in case of a potential increase in interest rates on operations in Belarusian rubles).

These findings based on the analysis of the financial sustainability indicators are supported by the results of stress testing as well. Stress testing showed that in the whole of 2006 the banking sector's sensitivity to credit and interest risks increased. It is also to be noted that, despite the fact that capital adequacy of most banks in case of said risks materialization remains at the level exceeding the minimum requirement, losses will be significant.

Modeling a situation where there is an outflow of natural and legal persons' funds shows that the banking sector will be able to meet its obligations to clients. However, the overall state of liquidity after the shock would significantly deteriorate, which in future would adversely affect the banking sector ability to make payments under its obligations based on maturity.

2.1. Financial soundness indicators

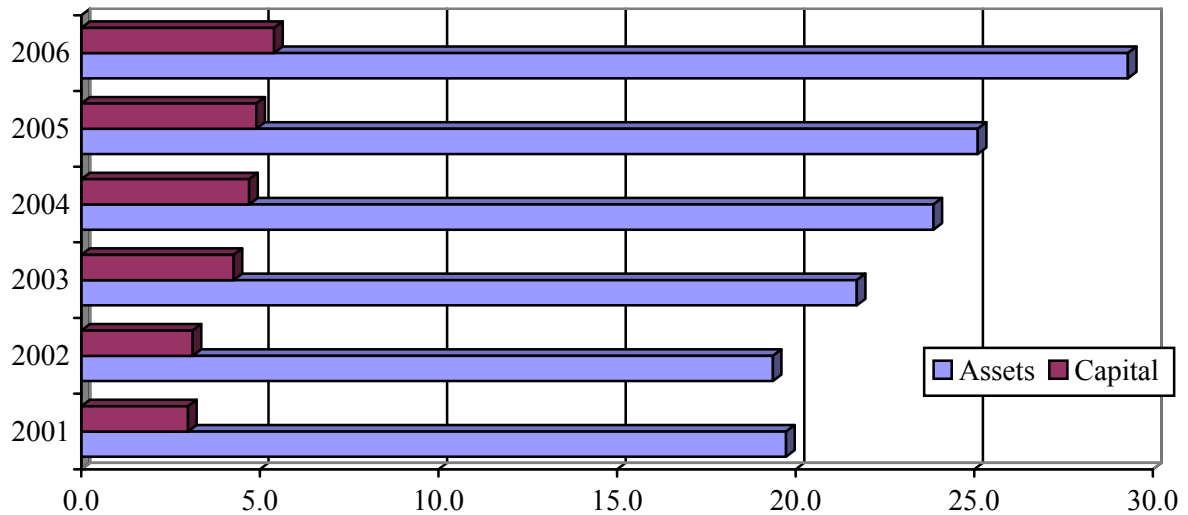
2.1.1 Ratio of banking sector development indicators to macroeconomic variables

Compared with 2005, the banks' assets grew in real terms in 2006 (adjusted for the GDP deflator) by 28.1% (by 15.2% in 2005), with real GDP increasing by 9.9%. Underlying the growth of the banking sector assets, like in previous years, was an increase in the banks' claims on the economy which grew in real terms by 31.3% (20.6%) from a year earlier. As a result, the ratio of the banking sector assets to GDP grew by 4.2%, amounting to 29.3% in 2006 (figure 14).

The rate of capital growth in the banking sector in real terms (adjusted for the GDP deflator) amounted to 22.3% against 13% in 2005, its average annual value with respect to GDP increasing from 4.9 to 5.4%.

In 2006, the banks' profit amounted to 411.2 billion Belarusian rubles, up 91.3% over 2005. As a result, the ratio of the banking sector profit to GDP rose from 0.33% in 2005 to 0.52% in 2006.

Figure 14. Ratio of Banking Sector Assets and Capital to GDP

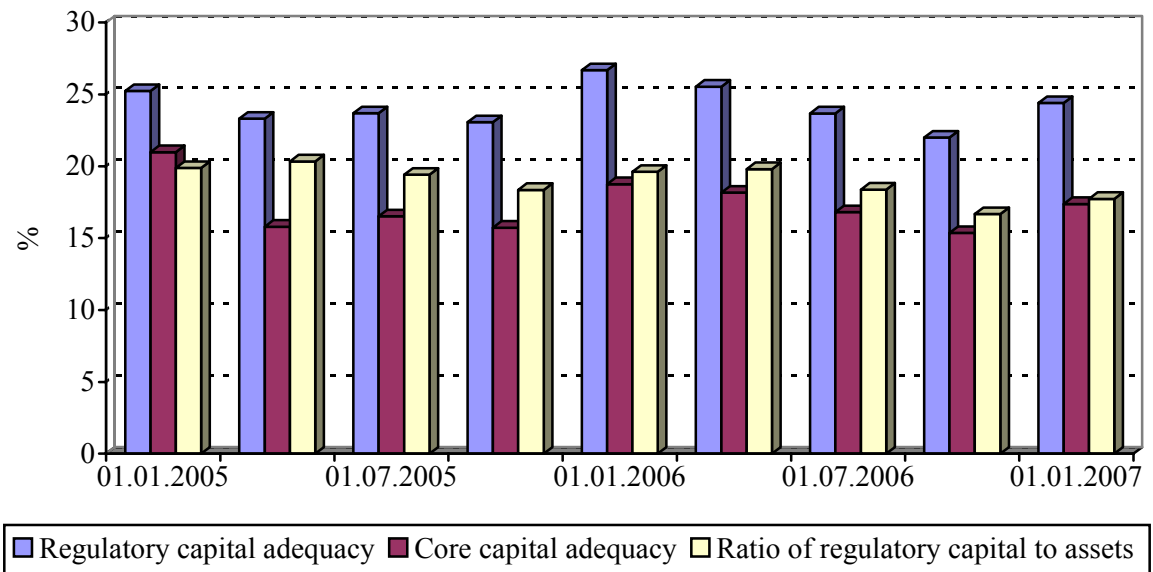


2.1.2. Macprudential indicators of banking sector performance

Capital adequacy. In 2006, the degree of capitalization in the banking sector was still high. Despite the fact that the indicator of regulatory capital adequacy of the banking sector was declining throughout 2006, it considerably exceeded the requirement of 8%, amounting to 24.4% as at January 1, 2007 (figure 15). Core capital adequacy (Tier I capital) was also decreasing during the year, remaining, however, at the level that exceeded the requirement of 4% and amounted to 17.4% as at the beginning of 2007.

Quicker growth of the banks' lending to the economy compared with the rates of regulatory capital build-up resulted in a capital adequacy decrease in the banking sector during 2006. This is also proved by the decrease of the ratio of regulatory capital to assets in the banking sector. The ratio dropped from 19.6% at the end of 2005 to 17.7% as of January 1, 2007.

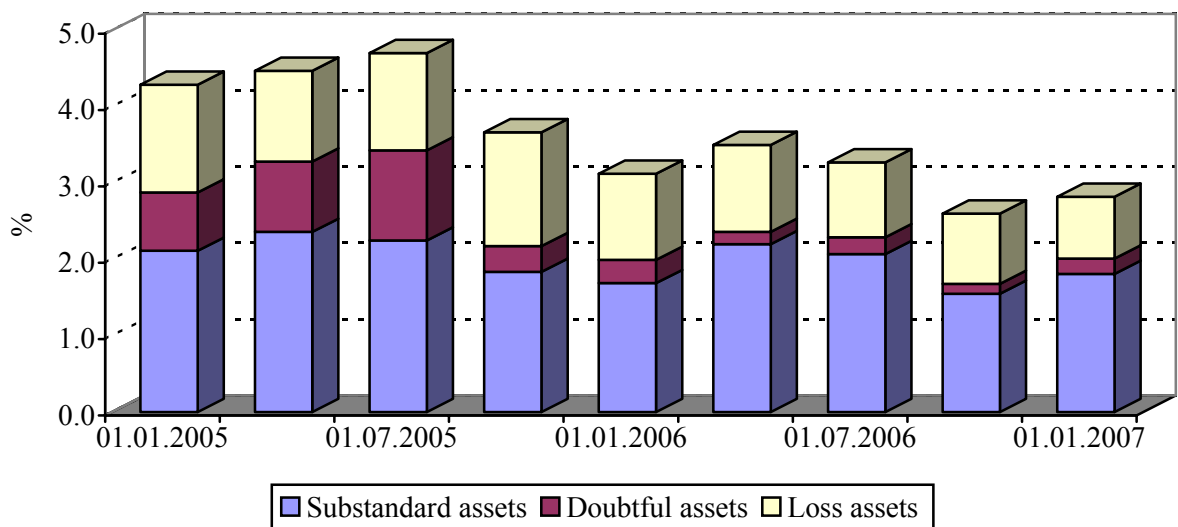
Figure 15. Capital Adequacy Indicators



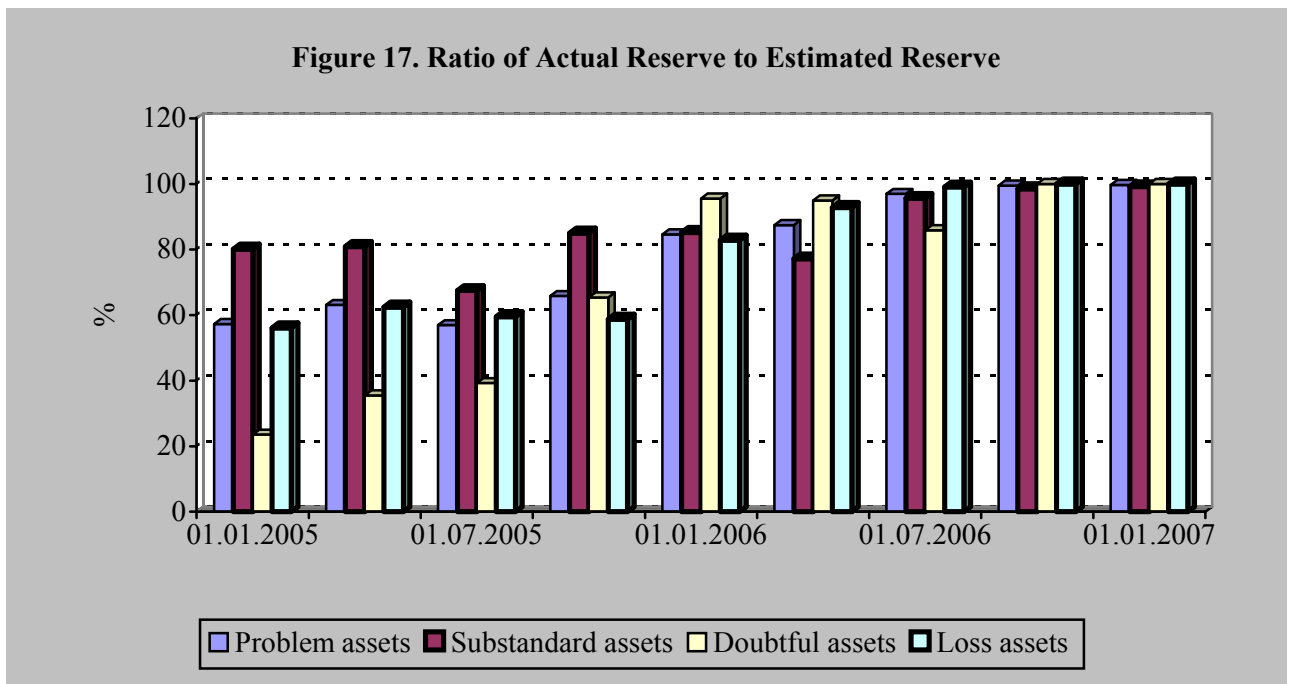
Asset quality. In 2006, the trend towards assets growth and improvement in the banking sector continued, with their quality improving (figure 16). The share of the banks' problem (substandard, doubtful, and loss) assets in the assets subject to credit risks declined by 0.3 percentage points and amounted to 20.8% as at January 1, 2007 (3.1% as at January 1, 2006).

The ratio of the actual reserve for potential losses on assets subject to credit risk to the estimated reserve continued to increase and by the end of 2006 almost reached the level of 100% for all categories of problem assets (figure 17).

Figure 16. Share of Problem Assets



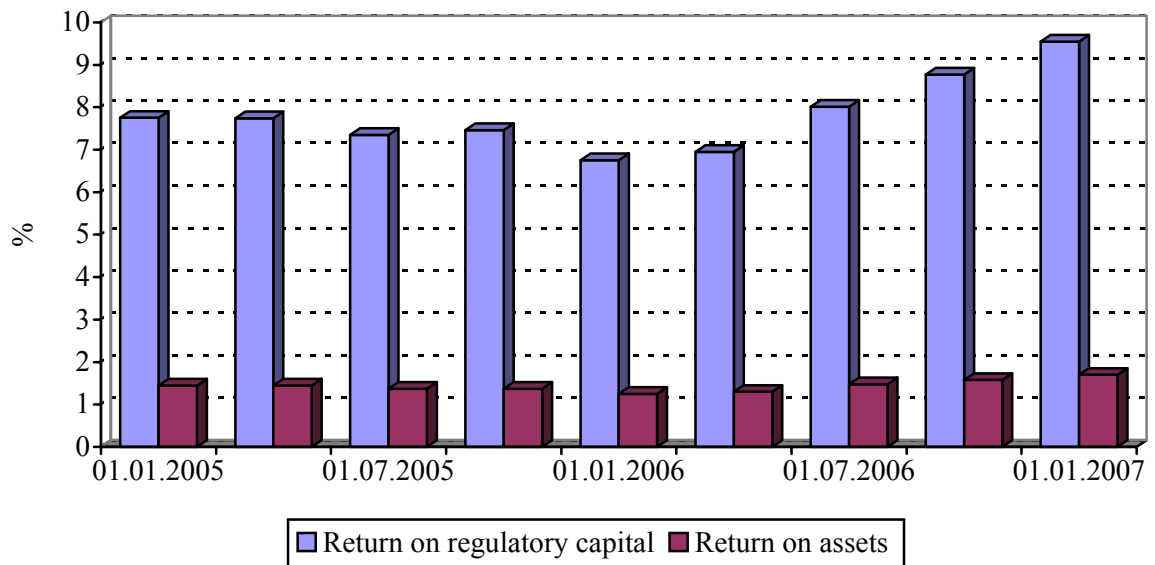
The ratio of problem assets (less the actual reserve for such assets) to regulatory capital was ranging from 4.6 to 8.3% during the year and amounted to 6.1% as at January 1, 2007 (6.3% as at January 1, 2006).



The share of problem (extended and overdue) debts in credit debts owed by clients and banks continued to decline in 2006 and accounted for 1.2% as at January 1, 2007. The decline of the problem debt share in the total volume of credit debts was chiefly due to high growth rates of the total sum of credit debts.

Management efficiency. In 2006, the indicators that characterize management efficiency in the banking sector increased. For example, the ratio of gross income to gross expenditure increased from 108.5 to 113.7%, while gross income per employee grew by 14.6 million Belarusian rubles, amounting to 62.8 million Belarusian rubles as at January 1, 2007. The ratio of non-interest expenditure to gross income dropped from 60% as at the end of 2005 to 53.5% as at the end of 2006.

Profitability. The downward trends observed in previous years in the dynamics of indicators characterizing banking sector profitability reversed in 2006. Return on assets rose from 1.25% in 2005 to 1.7% in 2006 and return on regulatory capital from 6.75 to 9.55% (figure 18).

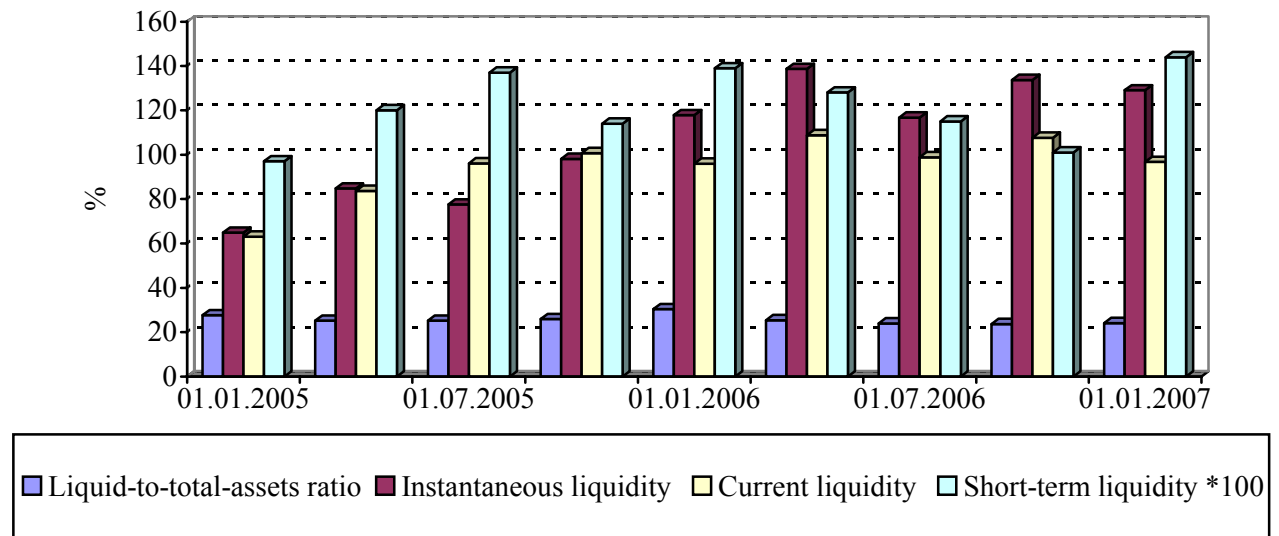
Figure 18. Banking Sector Profitability

Liquidity. During 2006, banking sector liquidity remained relatively high, while the share of liquid assets in the total sum of assets decreased. The ratio of liquid assets to total assets during the year was still exceeding the minimum requirement of 20%, the annual average value of this ratio being lower than in 2005. As at January 1, 2007, this ratio amounted to 24.1%, which is lower than the ratio as of January 1, 2006 by 6.3 percentage points (figure 19).

The dynamics of short-term liquidity (the ratio of assets with maturities of up to 12 months to liabilities with maturities of up to 12 months) experienced a downward trend throughout 2006. However, this figure increased by the end of 2006, amounting to 1.44 as at January 1, 2007 (1.39 as at January 1, 2006), the requirement being at least 1.

The instantaneous liquidity indicator (the ratio of total assets on demand to liabilities on demand and with overdue maturities) was significantly exceeding the requirement of 20% during the year and amounted to 129 % as at January 1, 2007.

Figure 19. Banking Sector Liquidity Indicators



Current liquidity (the ratio of total assets with remaining maturities of up to 1 month, including assets on demand, to liabilities with remaining maturities of up to 1 month, including liabilities on demand and overdue liabilities) was still high during the year and reached 96.7%, the requirement being at least 70%.

2.2. Risks in the banking sector

2.2.1. Credit risk

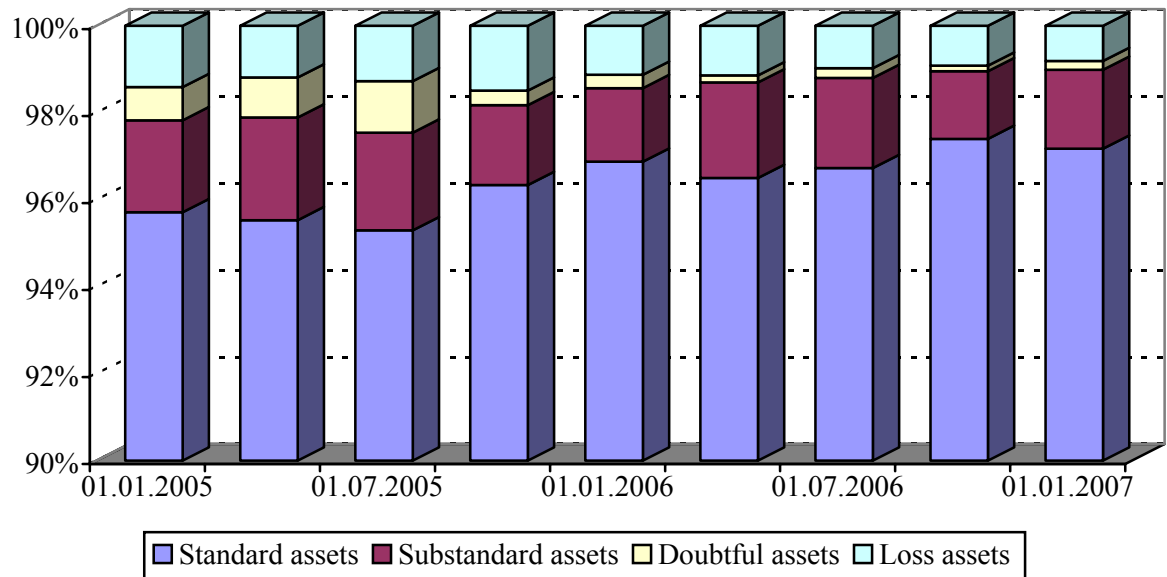
In 2006, rates of growth of the banks' assets operations related to the provision of loans to clients and banks increased significantly compared with 2005, their structure experiencing some improvement (figure 20).

The assets subject to credit risk grew by 45.7% in 2006 (38.3% in 2005), with the volume of problem (substandard, doubtful, and loss) assets increasing by 32% and amounting, as of January 1, 2007, to 647 billion Belarusian rubles (as at January 1, 2006, 490 billion Belarusian rubles). As a result, the share of the problem assets in the banking sector as a whole dropped by 0.3 percentage points, amounting to 2.8% as of January 1, 2007.

The share of the problem assets in the banking sector as a whole decreased owing to the improvement of assets quality in the state banks. The share of the problem assets in said banks declined from 3.1% as at January 1, 2006 to 2.7% as at January 1, 2007, whereas in other banks it increased from 3.2 to 3.3%. In 2006, assets quality deteriorated in 15 banks, whose share in

the assets of the banking sector amounts to 7.6% (8.4% in the assets subject to credit risk).

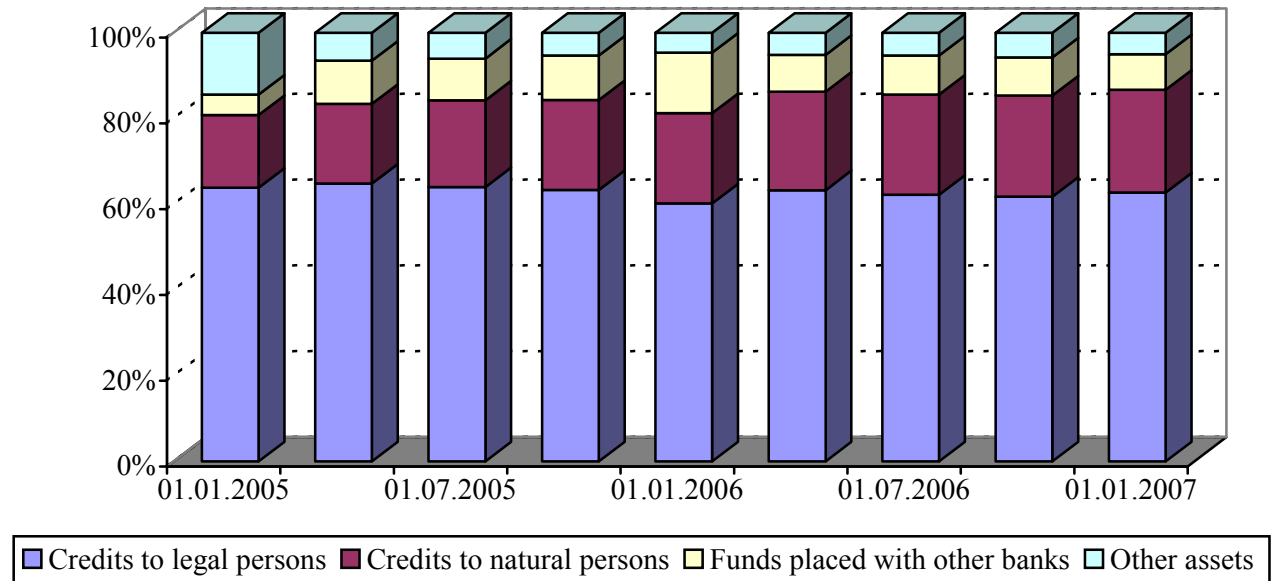
Figure 20. Quality of Assets Subject to Credit Risk



Credit debts of legal persons, credits granted to natural persons, and funds placed with the banks accounted for the largest share in the structure of the assets subject to credit risk in 2006 (figure 21). The quality of credits granted to legal persons improved compared to the previous year: the share of the problem assets among them amounted to 3.6% as at January 1, 2007, whereas as at January 1, 2006 it was 4%. In the structure of credits granted to natural persons the share of the problem assets was 0.8% (1.1% as at January 1, 2007), and the share of the problem assets placed with the banks remained close to zero.

In the structure of the problem credits granted to legal persons, substandard credits prevailed—71.5% as of January 1, 2007 (64% as at January 1, 2006), while the doubtful and loss credits accounted for 8.4% and 20.1%, respectively (5 and 31% as of January 1, 2006).

By type of activity of organizations that are banks' clients, the problem assets at the end of 2006 accounted for the biggest share in industry (4.6%), trade and catering (4.3%), agriculture (3.8%), and construction (3.4%). In 2006, the above share increased by 2.8 percentage points in construction, by 0.4 percentage points in agriculture, and by 0.2 percentage points in industry. In trade and catering it depreciated by 0.8 percentage points.

Figure 21. Structure of Assets Subject to Credit Risk

In 2006, the share of major credit risks was increasing at a lower rate compared to the growth of all assets subject to credit risk. As a result, the share of major credit risks in the total volume of assets subject to credit risk dropped from 14.9% as of January 1, 2006 to 13.9% as of January 1, 2007. The share of the state banks amounted to 11%, other banks' share being 25.4%. On the whole, the maximum size of major risks in all banks did not exceed their regulatory capital by more than six times.

The outstanding problem debts shown on the off-balance accounts increased somewhat during 2006 and as of January 1, 2007 amounted to 224 billion Belarusian rubles compared to 213 billion Belarusian rubles as at January 1, 2006. In the whole of 2006, their volume increased in 11 banks, whose share in the assets of the banking sector is 76.2%.

In 2006, the arrears of overdue and unreceived incomes shrank. As at January 1, 2007, they amounted to 157 billion Belarusian rubles, a 9.6% drop from 173 billion Belarusian rubles as at January 1, 2006 (figure 22).

2.2.2. Liquidity risk

Banking sector liquidity in 2006 was characterized by high volatility. The volume of liquid assets with respect to their aggregate amount was lower compared with 2005, this figure still exceeding the requirement of 20%. The liquid-to-aggregate-assets ratio amounted to 24.1% as at January 1, 2007 (30.4% as at January 1, 2006). Liquid assets denominated in Belarusian rubles enjoyed similar dynamics (figure 23). The liquidity dynamics in

foreign exchange was less stable ranging between 20 and 30 percentage points and by the end of 2006 declined to 20.1%.

Figure 22. Problem Arrears of Credit

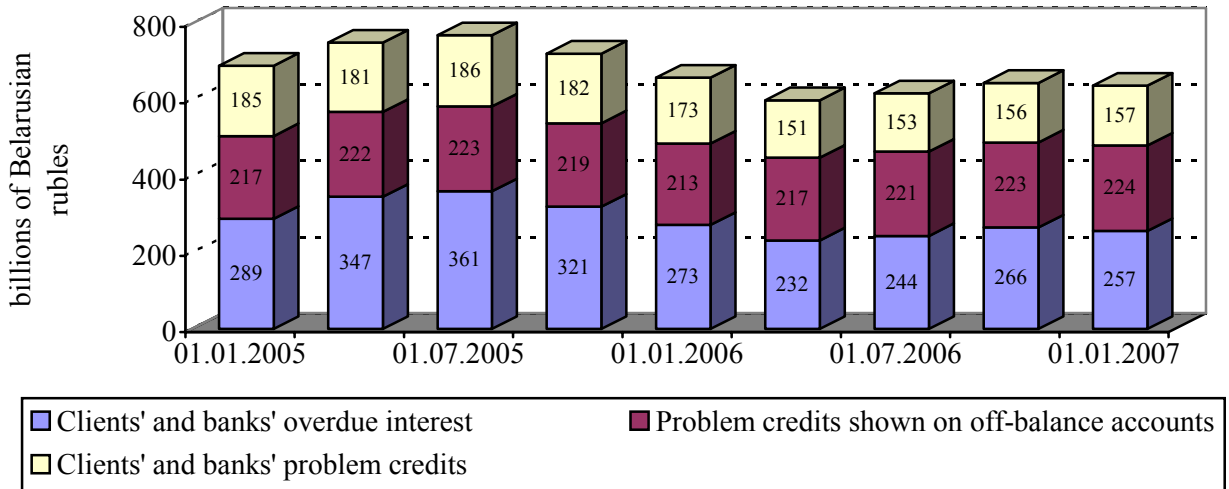
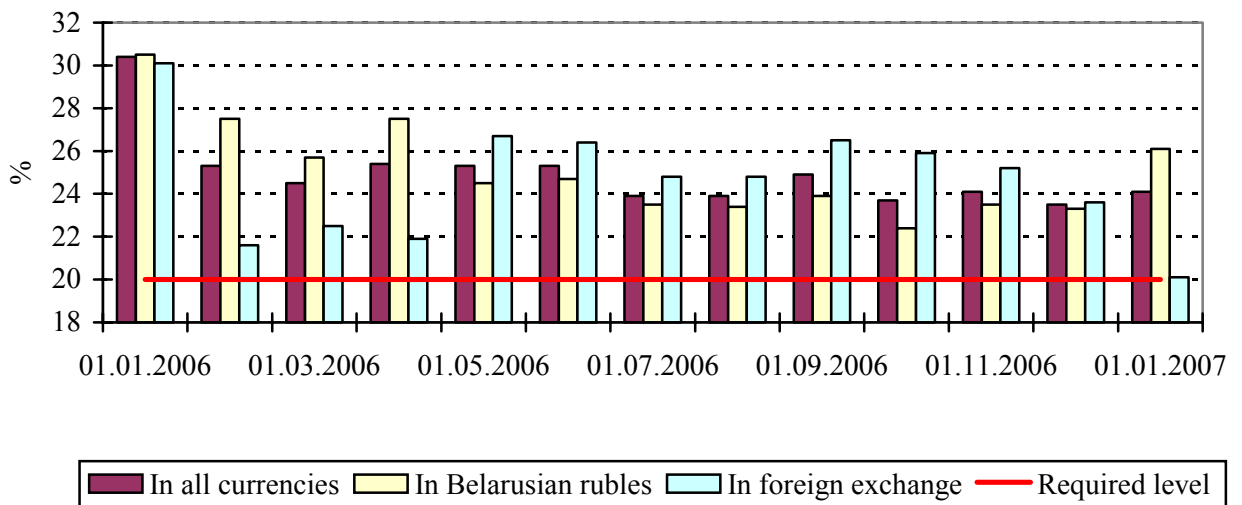
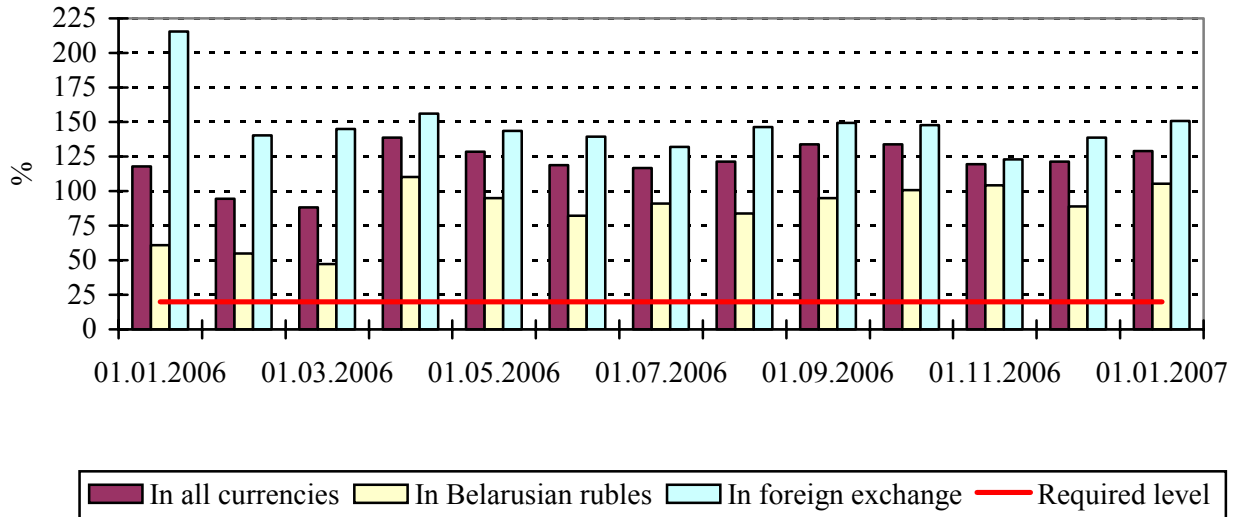


Figure 23. Liquid-to-Total-Assets Ratio



In 2006, **instantaneous liquidity** in the banking sector was considerably higher than the minimum permissible value (20%), ranging from 88 to 139%, which significantly exceeds the instantaneous liquidity level in 2005 (figure 24). Such high level of instantaneous liquidity was attained owing to the highly liquid assets denominated in foreign exchange. The minimum level of instantaneous liquidity denominated in foreign exchange was at the end of 2006–122.9%. The banks' instantaneous liquidity denominated in Belarusian rubles ranged from 47 to 110%, significantly exceeding the 2005 level.

Figure 24. Instantaneous Liquidity

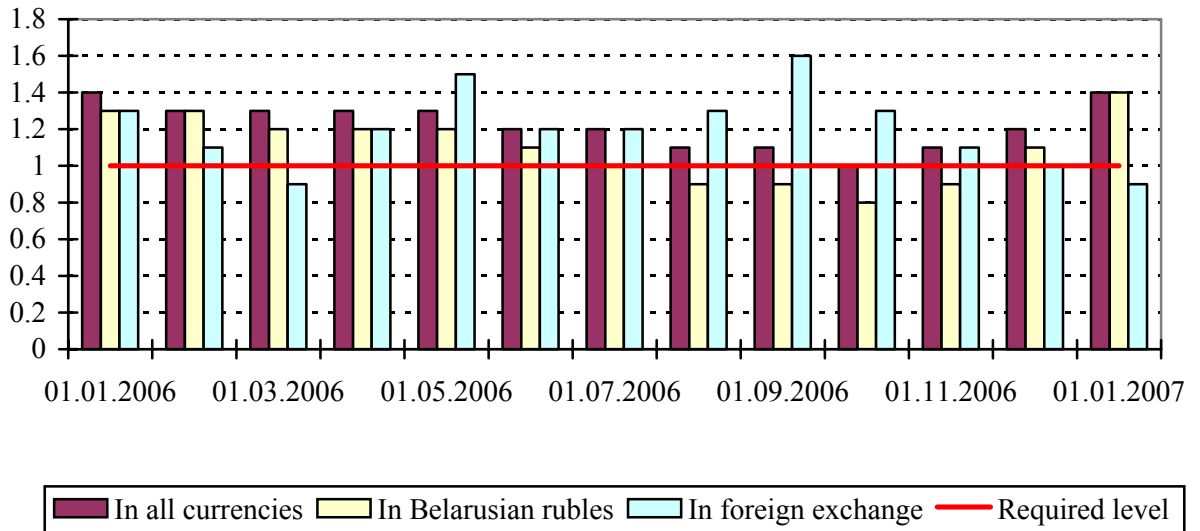


During 2006, **current liquidity** was ranging from 85.5 to 108.7% and amounted to 96.7% as of January 1, 2007 (95.9% as of January 1, 2006) exceeding its minimum permissible level (70%). Current liquidity denominated in Belarusian rubles and foreign exchange amounted to 78.9% and 125.4%, respectively, as of January 1, 2007.

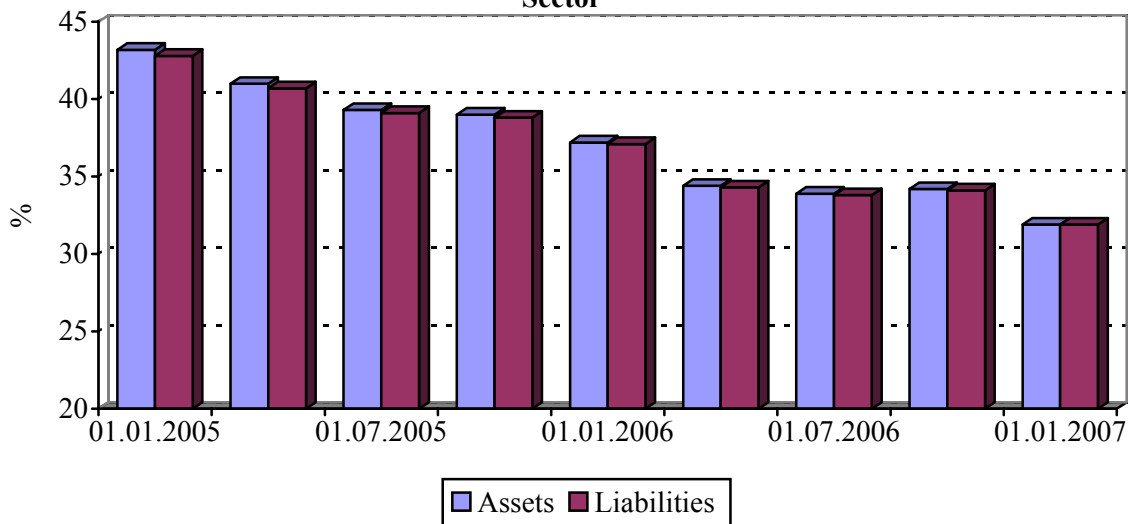
During 2006, high volatility was observed in the dynamics of the **short-term liquidity** ratio, though during the year this indicator did not fall below the prescribed requirement equal to 1 and ranged between 1 and 1.4 (figure 25). In the second half of 2006, the situation with banking sector liquidity was characterized, on the whole, by a decrease in said ratio, while liquidity denominated in Belarusian rubles and in foreign exchange on certain days was lower than 1.

2.2.3. Market risks

In 2006, market risk lowered compared with 2005 and amounted to 2.7% in the sum of credit-, market-, and operational risk-weighted assets and off-balance liabilities, which are used to calculate capital adequacy. At the same time the banks were most exposed to foreign exchange risk, whose share in market risk rose from 84.2 to 85.1%. The share of interest risk in market risk lowered from 10.6% as at January 1, 2006 to 10.4% as at January 1, 2007, of commodity risk from 2.2 to 3.6%, and of stock risk from 3 to 0.9%.

Figure 25. Short-term Liquidity of the Banking Sector

Foreign exchange risk. The tendency towards decreasing the share of foreign exchange in the assets and liabilities of the banking sector continued in 2006 (figure 26). As at January 1, 2007, the assets in foreign exchange amounted to 31.9% of the total assets of the banking sector, compared with 37.2% as at January 1, 2006, the liabilities in foreign exchange were 31.9 and 37.1%, respectively.

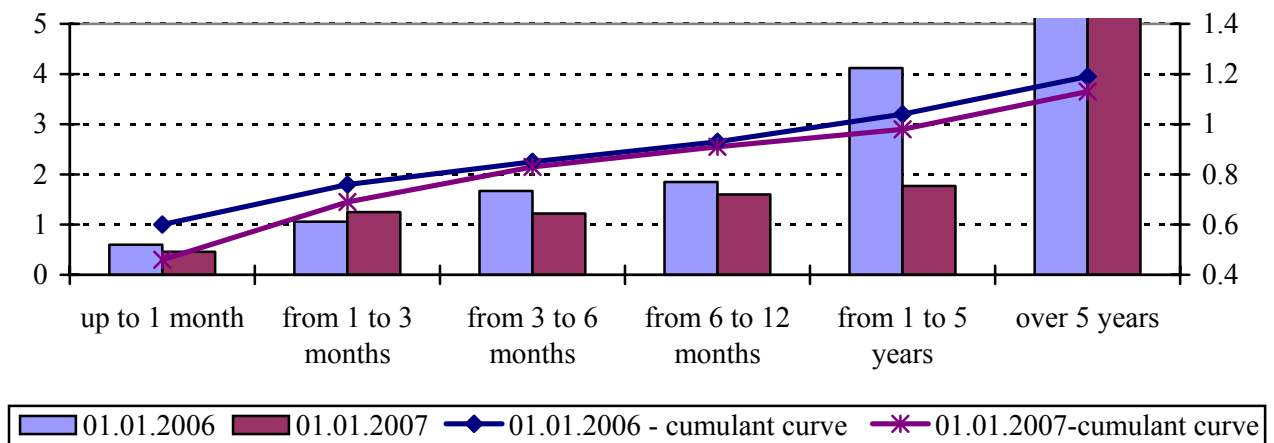
Figure 26. Foreign Exchange Share in the Assets and Liabilities of the Banking Sector

Financial instruments denominated in US dollars form the basis of the banking sector's foreign exchange claims and liabilities. As at January 1, 2007, their share in the total volume of claims and liabilities amounted to 60.2 and 60.8% (71.5 and 71.7% as at January 1, 2006), respectively. The share of claims and liabilities in euro increased compared with 2006 and amounted to 31.9 and 31.6% as at January 1, 2007 (20.8 and 20.9% as at

January 1, 2006), in Russian rubles 7.1 and 6.9% (7.4 and 7.1% as at January 1, 2006). This is an indication of a greater degree of vulnerability of the banking sector in case of a likely change in the exchange rate of the Belarusian ruble versus the US dollar, compared with other currencies.

Interest risk. In 2006, the ratio of assets to liabilities that are sensitive to changes in interest rates decreased (figure 27). Its cumulative value³ calculated with respect to the assets and liabilities whose maturity is less than one year decreased from 0.93 as at January 1, 2006 to 0.91 as at January 1, 2007, and with respect to all assets and liabilities from 1.19 to 1.13, respectively. Given this, we may conclude that during 2006 the banking sector became more vulnerable to the risk of interest rates increases.

Figure 27. Ratio of Assets and Liabilities Sensitive to Changes in Interest Rates



The narrowing cumulative relative gap⁴ between the assets and liabilities sensitive to changes in interest rates also reflects greater sensitivity of the banking sector to the growth of interests rates in 2006 (figure 28). In the time length up to one month the negative value of the relative gap is so big that it can not be compensated in the next five years.

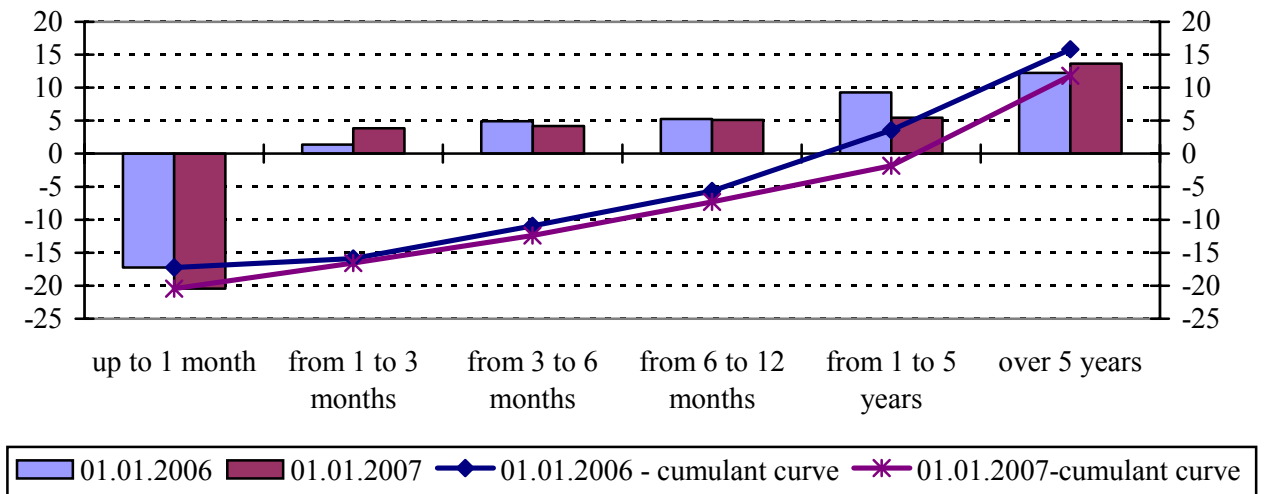
2.2.4. Operational risk

In 2006, operational risk increased by nearly 29.8%, while its share in the amount of credit-, market- and operational risk-weighted assets, which are used to calculate capital adequacy and off-balance liabilities, declined by 0.8% compared with 2005 and amounted to 11.5% as at January 1, 2007.

³ Cumulative value is calculated by summing all assets (liabilities) from the 1st time length to the chosen time length inclusive.

⁴ The relative gap is calculated as a ratio of difference between assets and liabilities belonging to one time length and all assets that are sensitive to changes in interest rates.

Figure 28. Relative Gap between Assets and Liabilities Sensitive to Changes in Interest Rates

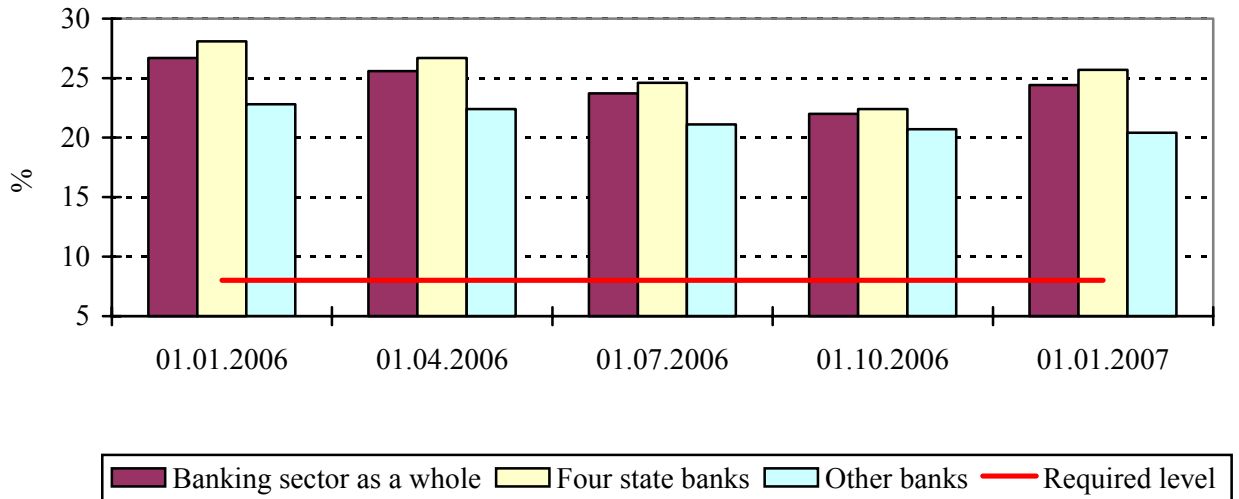


2.2.5. Banking sector capital adequacy

As of January 1, 2007, regulatory capital adequacy in the banking sector amounted to 24.4% (26.7% as at January 1, 2006), significantly exceeding the prescribed requirement (8%), including 25.7% at the state banks and 20.4% at the remaining banks (28.1 and 22.8% as at January 1, 2006, respectively), (figure 29).

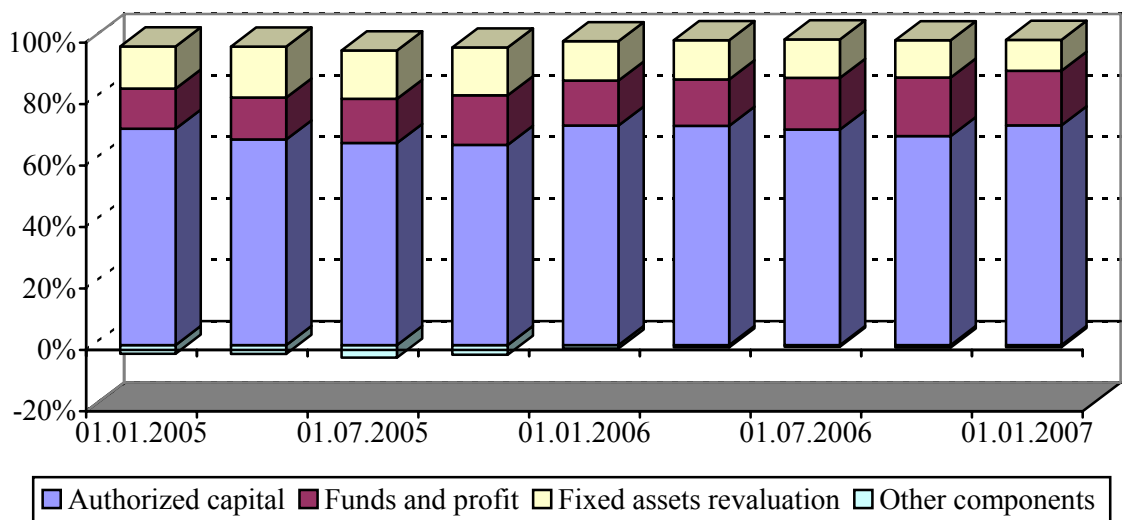
In 2006, core capital adequacy in the banking sector lowered by 1.3 percentage points and amounted to 17.4% as at January 1, 2007 (the prescribed requirement being 4%), including 19.1% in the state banks, and 12% in the remaining banks (20.9 and 13.2%, respectively, as at January 1, 2006).

The tendency towards increasing the banking sector's capitalization continued in 2006 with a view to minimizing banking risks and enhancing the banks' financial soundness. However, the tendency towards slowing growth rates of regulatory and core capital was also observed: the banks' core capital increased by 27.4% compared with 36% in 2005 and regulatory capital by 28% compared with 39% in 2005. At the same time, the total amount of risk-weighted assets and off-balance liabilities increased by 40% in 2006, up by nearly 8.6 percentage points compared with 2005.

Figure 29. Adequacy of Regulatory Capital of the Banking Sector

The state banks were building up their core and regulatory capital at a higher rate—31.1 and 32.9%, respectively, whereas in other banks its increment amounted to 12.3 and 11.7%, respectively.

Profit earned by the banks, along with the investments in the banks' authorized capital, was the main source of the banking sector's regulatory capital growth in 2006 (figure 30).

Figure 30. Structure of Regulatory Capital of the Banking Sector

2.3. Stress testing the banking sector

2.3.1. Basic conditions

In the course of stress testing, the impact of the following factors was assessed:

- impairment of the quality of the banks' credit portfolio;
- depreciation of the Belarusian ruble;
- rise in the interest rates on instruments in the national currency and foreign exchange; and
- withdrawal of liquid funds.

The degree of the Belarusian banking sector's vulnerability to credit risk was assessed under the following scenarios:

- an increase in the share of the problem assets by 15 percentage points, assuming that the structure of the problem assets would remain in proportions that are close to the shares actually existing as at the beginning of 2006 (scenario 1); and

- an impairment of the assets quality by one category of classification, assuming that 20% of the standard assets would become substandard, all substandard assets would become doubtful assets, and all doubtful assets would become loss assets (scenario 2).

The degree of the banking sector's vulnerability to foreign exchange risk was assessed based on the assumption that the Belarusian ruble depreciated against the US dollar by 20% (scenario 3). Besides, a stress test was performed under the scenario that combined foreign exchange and credit risks. The following assumptions were made for this scenario: the depreciation of the Belarusian ruble against the US dollar by 20% would lead to a situation where 80% of credits in foreign exchange granted to the agricultural and construction sectors and households, as well as 20% of credits granted to industry and other sectors, would become problem credits and would be classified as loss ones (scenario 4).

The banking sector's vulnerability to interest risk was assessed based on the assumption that the yield curve in Belarusian rubles and in foreign exchange increases in parallel, by 10 percentage points (scenario 5) and by 5 percentage points (scenario 6), respectively.

For the purpose of simulating shocks in stress testing the banking sector's vulnerability to liquidity risk, the natural and legal persons were to withdraw 10% of the funds placed with the banks (scenario 7).

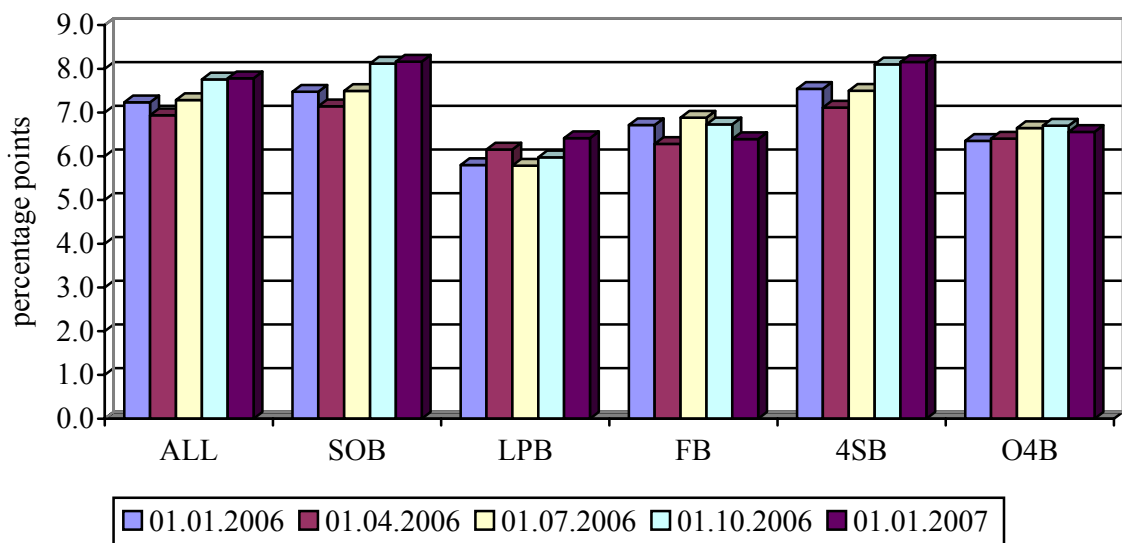
Subject to stress testing were both each individual bank and the banking sector as a whole (Group 1 – “ALL”), as well as certain groups of banks. For example, Group 2 (“SOB”) included banks in which the organs of state administration and state entities had a majority shareholding; Group 3 (“LPB”) included local private banks; Group 4 (“FB”) included banks with a dominant share of foreign capital in their authorized capital (hereinafter – “foreign banks”). The state banks formed a separate group (Group 5 – “4SB”), while the remaining banks were included in Group 6 (“O4B”).

2.3.2. Obtained results

Scenario 1. The increase in the share of the banks’ problem assets by 15 percentage points (assuming that 50% of them become substandard, 15% doubtful, and 35% loss assets) would result in the decrease of the aggregated capital adequacy ratio (CAR) by 6.9-7.8 percentage points (figure 31). Banks in which the state has a dominant share would be hit hardest—the “SOB” and “4SB” groups’ CAR would decline within the range of 7.1-8.2 percentage points. In other groups, the CAR would decrease within the range of 5.8-6.9 percentage points.

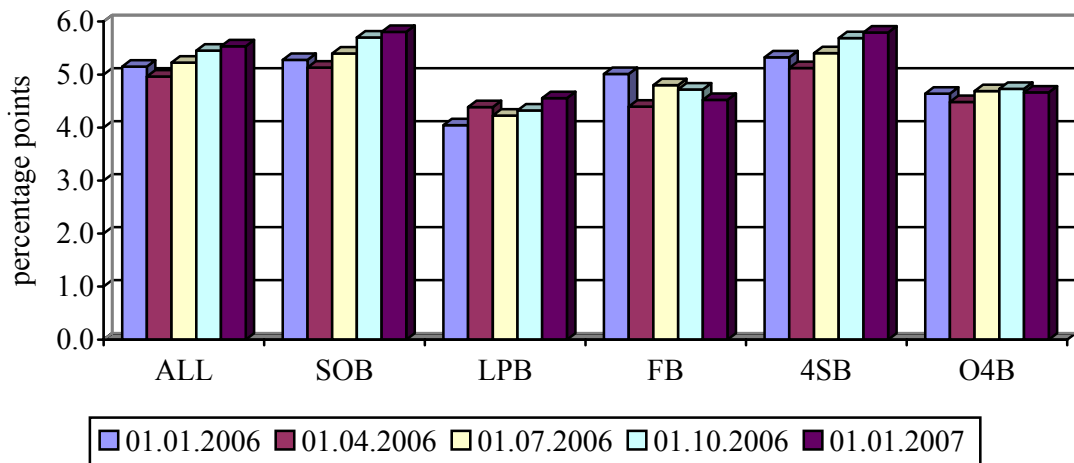
By the end of 2006 the banks’ susceptibility to such kind of shock increased, and this tendency can be traced across practically each group under consideration (excluding the “FB” group). At the same time, in case a similar shock occurs during 2006 the CAR of the groups under consideration would be higher than the prescribed requirement.

Figure 31. CAR Decrease (Scenario 1)



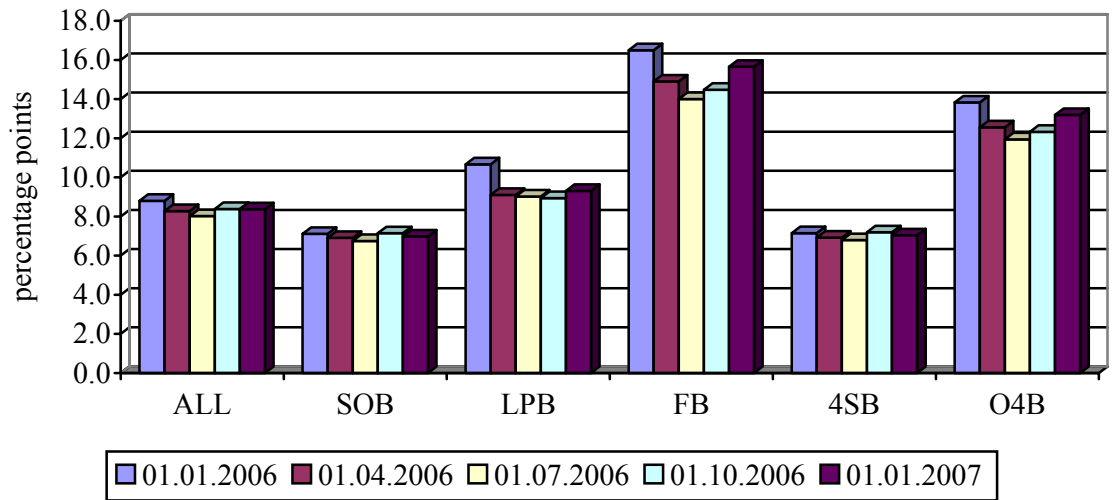
Scenario 2. In case of impairment of assets quality by one category of classification (20% of standard assets become substandard, all substandard assets become doubtful assets, and all doubtful assets loss assets) negative consequences for the banking sector would be less significant compared with scenario 1. The aggregated CAR would decrease within the range of 5.0-5.5 percentage points, while its dynamics would experience an upward trend (figure 32).

Figure 32. CAR Decrease (Scenario 2)

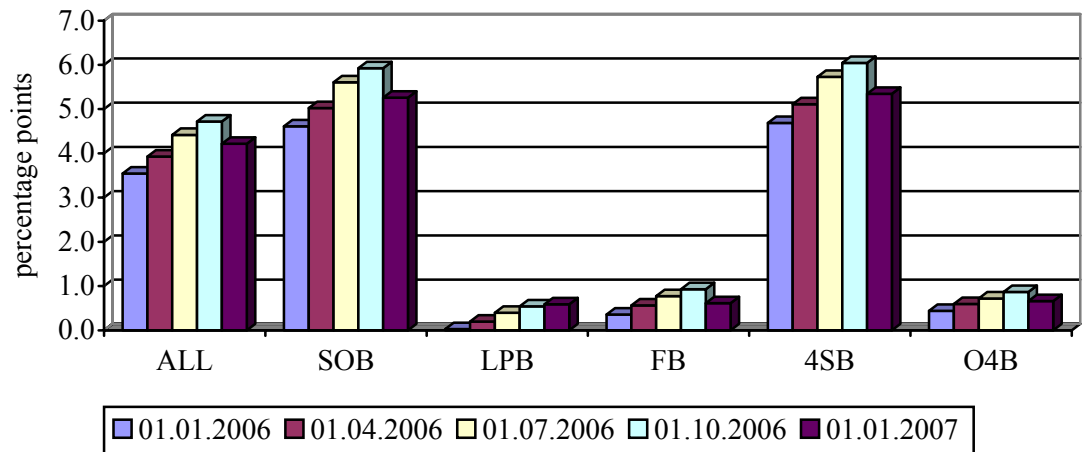


Scenario 3. The results of examining the banks' vulnerability in case of the Belarusian ruble depreciation against the US dollar by 20% prove that the decrease in the aggregated CAR and CAR by group would be insignificant: the CAR would decline by 0.1-0.5 percentage points.

Scenario 4. In cases where credit and foreign exchange risks combine (based on the assumptions made) the aggregated CAR would decrease by 8.0-8.8 percentage points (figure 33). The "FB" group would be hit hardest, their CAR decreasing by 14-16.5 percentage points, the "SOB" group would be least hit (by 6.7-7.1 percentage points). The "FB" group is the only one whose CAR would be lower than the prescribed requirement if such shock occurs.

Figure 33. CAR Decrease (Scenario 4)

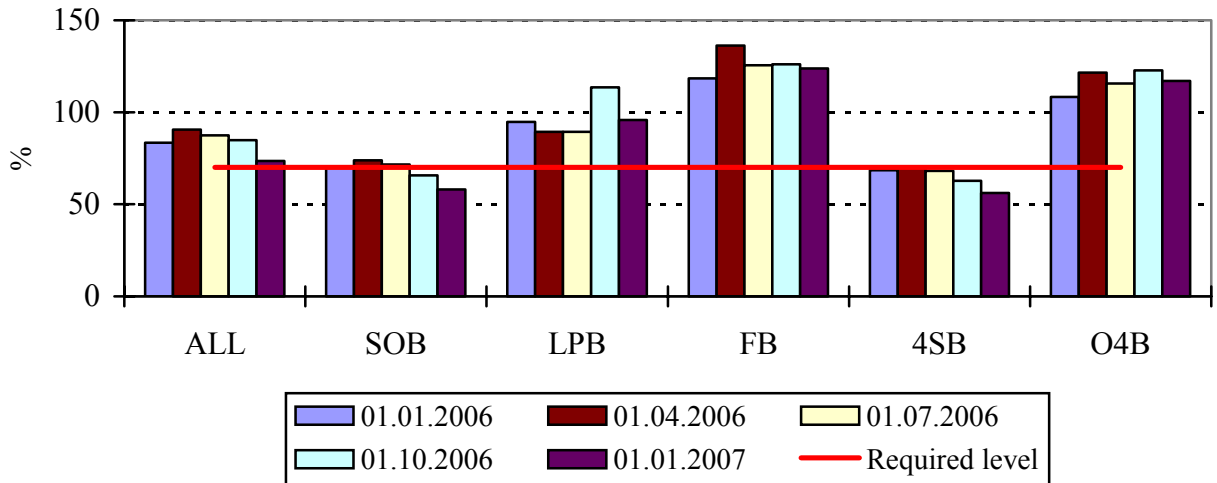
Scenario 5. Should the yield curve in Belarusian rubles increase by 10 percentage points, the aggregated CAR would decrease by 3.5-4.7 percentage points (figure 34). In this case, the state banks would be hit hardest. The “4SB” group’s CAR would decrease by 4.7-6.0 percentage points, whereas other banks’ CAR by 0.6-0.9 percentage points.

Figure 34. CAR Decrease (Scenario 5)

Scenario 6. Stress testing of the banking sector’s vulnerability to the increase of the yield curve in foreign exchange by 5 percentage points found that the banks’ exposure to this kind of risk was insignificant. If such shock occurs, the CAR of the whole banking sector as well as of the groups of banks in question would not exceed 0.5 percentage points.

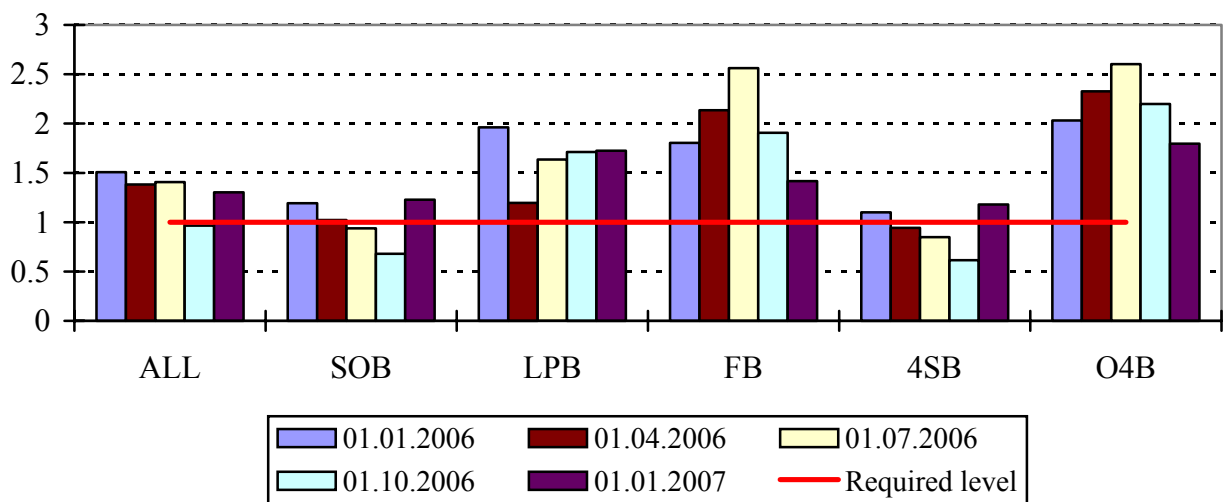
Scenario 7. In case of withdrawal by natural and legal persons of 10% of the funds placed with the banks, the current liquidity ratio (CLR) of the banking sector, though decreasing by 11-23 percentage points, would still exceed the prescribed requirement (figure 35). The CLR decrease would be greatest in the “4SB” group (by 18-32 percentage points), causing the CLR of this group to decline to 56-70%.

Figure 35. CLR after Shock (Scenario 7)



Overall, similar situation would also be observed in the dynamics of other liquidity ratios, in particular of the short-term liquidity ratio (SLR). If after the shock the SLR for the whole banking sector exceeds 1, the groups that include state banks would see it dropping below the prescribed requirement (figure 36).

Figure 36. SLR after Shock (Scenario 7)



The set of scenarios discussed above embraced all material risks characteristic of the banking activity in the Republic of Belarus in 2006. The findings of stress testing supported the conclusions based on analyzing the indicators of financial soundness, namely, that the banking sector's sensitivity to credit and interest risks was increasing and that inconsistencies between the banks' assets and liabilities operations in the time structure were still significant.

3. Banking supervision development

3.1. Banking supervision organization

In 2006, the entire complex of prudential requirements to mitigating risks of the banks' activity was improving, including approaches to calculating capital adequacy in order to ensure a fuller coverage of risks taken by the banks in the course of operation and to make provision for potential losses, and consolidated supervision was in the process of establishment.

In accordance with the Program of Development of the Banking Sector of the Economy of the Republic of Belarus for 2006-2010 which defines the national strategy of banking sector and banking supervision development in the medium term, objectives and tasks of banking supervision development are determined by the need to ensure secure and sound functioning of the banks. Their attainment is associated with the improvement of prudential requirements and supervisory procedures and is implemented by upgrading all the component parts of the supervisory process, i.e. licensing, off-site supervision, examinations, sanctions, and analysis of systemic banking risks.

Further improvement of banking supervision will continue to be geared towards implementation of the international standards, including those established under the Basel Capital Accord. Initially, the implementation of Basel II standards must be based, as much as possible, on the implementation of the Core Principles for Effective Banking Supervision in accordance with the recommendations of the international financial institutions.

Underlying supervision development in 2006-2010 will be:

1) implementing supervision aimed at the assessment and mitigation of risks by means of:

- optimizing prudential reports, bringing them as close as possible to intrabank management reports, which would make it possible to perform both quantitative and qualitative analysis of risks parameters and their management;

- improving the system of early warning of problem situations at the banks, and

- enhancing the role of the professional judgment of the National Bank's specialists when assessing the banks' financial condition and prospects of their functioning (based on off-site supervision and inspections), as well as when making decisions as to what follow-up supervisory actions with respect to each specific bank should be taken (frequency and scope of follow-up inspections, sanctions, etc.);

2) implementing consolidated supervision over activities of banking groups and banking holding companies based on consolidated reports; heightening attention to the activity of persons who are connected with the banks and who are able to exert significant influence on the banks' activities, risks, and financial condition;

3) imposing higher requirements to the provision of access to the market of banking services, including requirements to:

- transparency of the banks' ownership structure and business reputation of the banks' major promoters (shareholders);

- business plans of banks to be established, including procedures for their preparation and assessment, and

- the quality of corporate governance, in particular, business reputation of managers and members of supervisory boards (boards of directors), the quality of strategic planning, and the development of the banks' risk management and internal control systems.

The National Bank's relationship with other banks aimed at increasing the banking sector's sustainability will continue to be based on the development of the regulatory framework governing the banks' activities and the improvement of supervision and control over their functioning. Steps undertaken in the field of banking supervision improvement will enhance the development and sustainability of the banking sector whose indicators

(assets' volume and quality, size of regulatory capital and its adequacy, profitability, and compliance with the prudential standards) showed positive dynamics in 2006.

3.1.1. Legal backing of banking supervision

The legislative fundamentals of banking supervision have been set forth in the Banking Code and are made specific in regulatory legal acts of the National Bank. The enactment of the Law of the Republic of Belarus "On Modifying and Amending the Banking Code of the Republic of Belarus" dated July 17, 2006, that went into effect on October 27, 2006, significantly extended the National Banks' powers in the field of supervision organization and implementation.

In improving the regulatory and methodological framework of banking supervision in 2006, the National Bank was focusing on drafting and adopting new regulatory legal acts and bringing the current ones in line with the revised Banking Code that extended the powers of the National Bank in the sphere of banking supervision.

The activities aimed at bringing regulatory legal acts in line with the revised Banking Code of the Republic of Belarus are planned to be completed in 2007.

The key regulatory documents of the National Bank of the Republic of Belarus related to banking supervision are available on the National Bank website at <http://www.nbrb.by/legislation/licensing.asp>.

3.1.2. Organizational backing of banking supervision

Supervisory authority functions at the National Bank are entrusted to the Banking Supervision Directorate and relevant units of the regional Main Departments of the National Bank.

A Banking System Stability Committee has been functioning on an ongoing basis. It is a collective body which generates optimal management decisions on currently central issues of banking system development pertaining to:

- the improvement of the regulatory legal framework in the field of banking supervision and foreign exchange regulation; and

- the maintenance of banking system stability and development of measures designed to protect the interests of the banks' depositors and creditors.

Decisions of the above Committee are binding on the organizational units of the National Bank.

A special Commission has been set up with a view to exercising control over the compliance by the banks with the indicative parameters of banking sector development. The Commission is a collective body which is accountable to the Chairman of the Board of the National Bank. It comprises 9 persons, including its Chairman who is First Deputy Chairman of the Board of the National Bank in charge of banking supervision.

During its meetings the Commission receives reports of the banks' top managers regarding the financial condition of the banks and efforts they make to comply with the indicative parameters of development, organizes the analysis of proposals aimed at improving the regulatory legal acts governing banking activity, and comes up with appropriate recommendations.

A Commission evaluating financial soundness of the banking system of the Republic of Belarus holds its meetings on a monthly basis. It comprises 9 persons, including its Chairman (First Deputy Chairman of the Board of the National Bank in charge of banking supervision).

The Commission reviews the main trends in the economy and monetary sphere and their relevance for assuring the banks' financial soundness and develops measures aimed at preventing the destabilization of the banking sector and maintaining its sustainable performance.

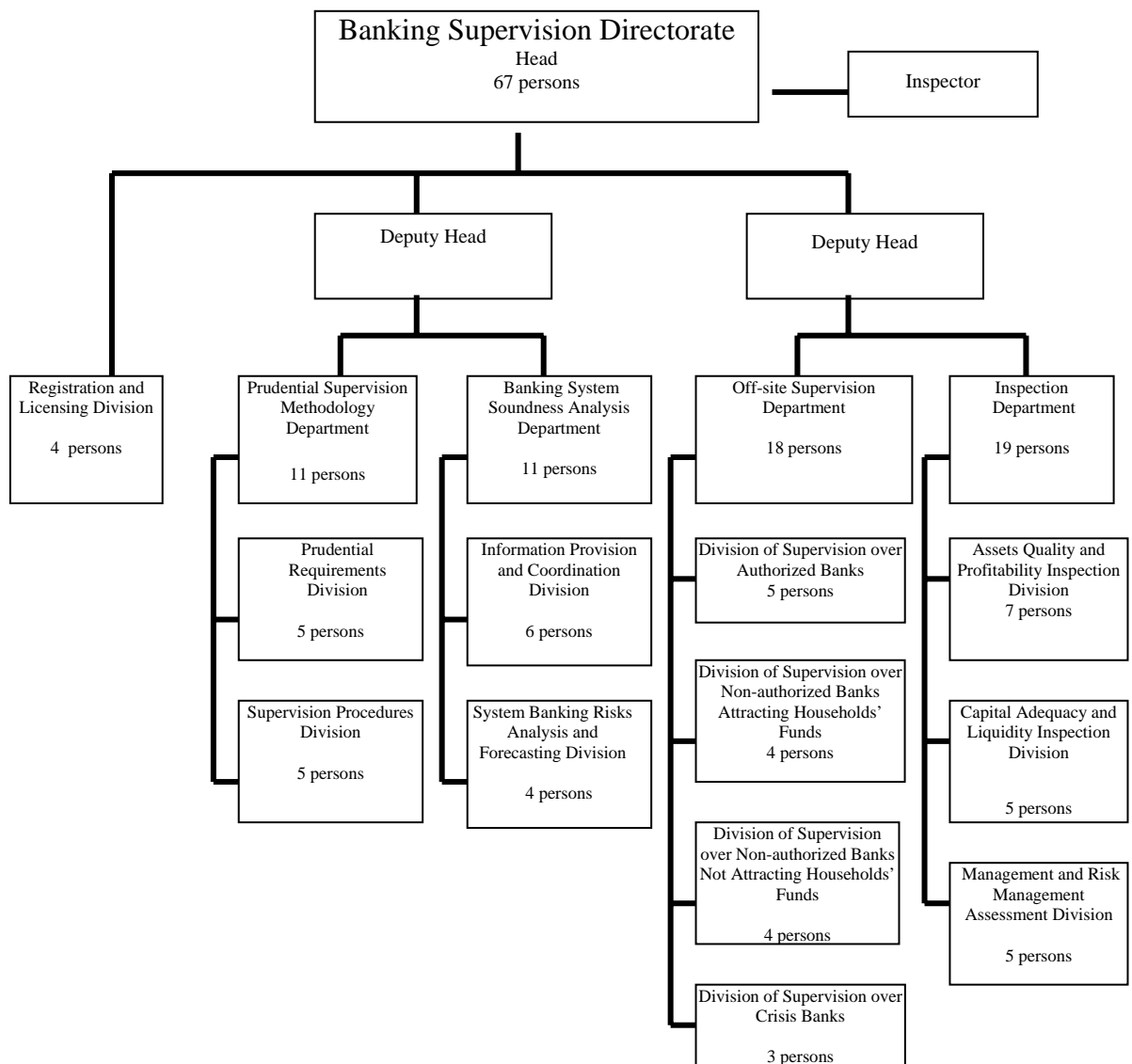
Besides, the Commission coordinates the actions of the organizational units of the National Bank's main office directed towards accumulation and processing of information that characterizes the current state of the banking sector and prospects for its development.

3.1.3. Banking supervision staff

Banking supervision at the National Bank is carried out by 131 specialists, of whom 48.9% are employees of regional agencies and 51.1% are employed at the Banking Supervision Directorate of the main office.

All employees of the Banking Supervision Directorate of the main office are graduates of higher educational establishments, of them 22.4% are under 30 years of age, and 25.4% have been working in the banking system for 15 years or more.

Skills of the employees of the National Bank who are involved in banking supervision are constantly upgraded by means of distance education under the FSI Connect program of the Financial Stability Institute of the Bank for International Settlements (Switzerland), attendance of national and international seminars and conferences, participation in provisional (crisis) managers' training program, and courses of government assessment of property.



3.2. Methodological fundamentals of banking regulation and supervision. Compliance with international principles and approaches in the course of banking regulation and supervision

3.2.1. Banks' registration and licensing of banking activities

Amendments and modifications made to the Banking Code with a view to registering banks and licensing banking activities provide for:

- a switch to the issuance of a single special authorization (license) to carry out banking activities listing therein banking operations the bank is entitled to engage (in line with Resolution of the Board of the National Bank of the Republic of Belarus No. 171 "On amendments and modifications to Resolution of the National Bank of the Republic of Belarus No. 175 dated June 28, 2001" dated October 31, 2006, the Instructions on state registration of banks and non-bank financial institutions and licensing of banking activities were redrafted). The revised version of these Instructions eliminated the multiplicity of banking licenses. Depending on the bank's willingness and preparedness to perform certain operations as well as on the assessment of such willingness by the National Bank, the list of operations each bank is authorized to engage will be stipulated in the single license. This, in turn, will allow a more flexible approach towards imposing on the banks such sanctions as limitation of powers under license. Moreover, criteria for assessing financial soundness of the bank have been established in order to determine the possibility of authorizing the bank to perform individual banking operations, inter alia, related to the attraction of monetary funds from natural persons. Such criteria cover, in particular, the transparency of the bank's ownership structure, its capital adequacy and structure, the assets quality, the financial efficiency, the state of liquidity, and the management quality;

- conferment on the National Bank of the right to set requirements with respect to the contents of business plans submitted for state registration of the banks to be established and criteria for their assessment. This will make it possible to bar the banks indubitably lacking vitality from the banking sector of the Republic of Belarus. Resolution of the Board of the National Bank of the Republic of Belarus No. 22 dated January 25, 2007 approved the Instructions on criteria for assessing and procedures for compiling a business plan of a bank and non-bank financial institution. The above-mentioned Instructions also stipulate that failure of the business plan to comply with the prescribed criteria constitutes grounds for refusing state registration of a bank;

- setting requirements to business reputation of the nominees for the posts of the manager and chief accountant of the bank or non-bank financial institution and its branch as well as their deputies. An assessment of compliance with said requirements shall be made in cases where a bank and non-bank financial institution is established or its branch is opened, new persons to the posts mentioned above are appointed, and an appropriate sanction prescribed by the Banking Code is imposed on the bank or non-bank financial institution (Resolution of the Board of the National Bank of the Republic of Belarus No. 140 dated September 28, 2006 approved the Instructions on assessment of the compliance of the nominees for the posts of the manager and chief accountant of the bank or non-bank financial institution and its branch as well as their deputies with qualifying requirements and requirements for business reputation; and

- extending the list of grounds for refusing state registration of a bank as regards non-compliance of the nominees for the posts of the manager and chief accountant of the bank or non-bank financial institution with qualifying requirements and requirements for business reputation as well as detection of inadequate information in the documents submitted for state registration of the bank and failure of the business plan to comply with prescribed criteria for the assessment thereof.

Special conditions of the banks' functioning in the free economic zones of the Republic of Belarus, that included both the provision of prudential preferential terms and restriction of the number of counterparties in operations, were rescinded in 2006. Newly established banks registered in the free economic zones will now abide by the same rules for the establishment and functioning as other Belarusian banks. The previously registered banks-residents of the free economic zones are given the task of bringing their regulatory capital to the generally established levels within a specified period of time, following which they will also have to adhere to the same rules.

3.2.2. System of secure functioning requirements

The Instructions on secure functioning requirements for the banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 137 dated September 28, 2006 which are a revised version of the Instructions on prudential regulations for the banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 92 dated June 28, 2004 were adopted in 2006 with a view to streamlining the regulatory and

methodological framework of banking supervision. This document became effective on January 1, 2007.

Instructions No. 137 brought terms and concepts in line with the revised version of the Banking Code, made a number of adjustments to the calculation of regulatory capital, assets and liabilities, and instantaneous liquidity requirement, and changed approaches to the inclusion of off-balance liabilities denominated in foreign exchange when calculating the foreign exchange position. Because of the shorter list of mandatory secure functioning requirements, these Instructions do not include a number of requirements remaining in force until January 1, 2007 which are declared inefficient based on the results of their employment in previous years. In particular, the requirements for the maximum amount of risk per creditor (depositor), maximum amount of own bill liabilities, and maximum amount of funds attracted from natural persons were rescinded.

3.2.3. Requirements for provisioning for potential losses on assets

With a view to harmonizing requirements for provisioning for potential losses on assets subject to credit risk and off-balance operations as well as reimbursing to a fuller extent potential losses resulting from banking activities, the National Bank drafted and the Board of the National Bank of the Republic of Belarus approved by Resolution No. 138 dated September 28, 2006 the Instructions on procedures for making provision for potential losses on assets and off-balance operations and using such provision. These Instructions combine requirements for provisioning for both banks' assets operations (assets subject to credit risk and securities) and off-balance operations (hereinafter – “conditional liabilities”).

In an effort to bridge, in the course of provisioning, a large gap between standard and doubtful assets, an additional intermediate classification group has been introduced and the possibility of creating a reserve in the amount of 10% on the debt which can not be classified as standard has been provided for; however, the problems relating to its repayment are insignificant.

3.2.4. Supervision on a consolidated basis

Prior to the adoption of the revised version of the Banking Code the right of the National Bank to exercise supervision on a consolidated basis was not enshrined in law. At the same time the banks were filing

consolidated financial reports with the National Bank in accordance with the requirements laid down in the Instructions on compiling and furnishing consolidated financial reports by the banks of the Republic of Belarus approved by Resolution of the Board of Directors of the National Bank of the Republic of Belarus No. 414 dated December 27, 2002. Information on own funds and the ratio of own funds to the assets of the group, major risks of the group, and risks of the group by insiders of the banks-members of the group was also furnished.

The establishment of the system of consolidated supervision over the banks' activities is closely related to the amendments and modifications made to the Banking Code in 2006. The National Bank is now authorized to carry out consolidated supervision over the banking activities taking into account financial condition and risks of legal persons whose decisions taken by their governing bodies are significantly influenced, directly or indirectly (via third parties) by the bank, as well as legal persons who exert such influence on financial condition and risks of the bank.

Nowadays, the National Bank is in the process of forming the instruments of consolidated supervision.

3.3. Forms and methods of supervision

3.3.1. Off-site supervision

Off-site supervision is a component part of ongoing supervision and is based on the analysis of the balance sheet and prudential reports provided by the banks, inspections documents of the National Bank, and other information pertaining to banking activities.

The primary objective of off-site supervision is to implement the entire range of supervisory response measures aimed at ensuring secure and liquid functioning of the banks, protecting their depositors and creditors, minimizing the number of bank bankruptcies, and reducing costs relating thereto.

In 2006, the National Bank chose to abandon the practice of establishing in the Republic of Belarus banking institutions that have a number of preferences regarding compliance with the prudential regulations, including the requirement to the minimum amount of regulatory capital and requirement to the minimum amount of authorized capital. Similar preferences were granted to the banks registered as residents of the free economic zones.

The banks' compliance with the secure functioning requirements and indicative parameters of development prescribed by the National Bank were constantly followed throughout the year.

Efforts directed towards discontinuation of granting preferences regarding banks' compliance with the prescribed prudential regulations and limitations were carried on in 2006. At the same time, in the year under review a number of preferences were in force which stemmed from the need to service the government programs by the banks as well as the need to adapt the banks to the changes in banking legislation which tightened requirements to regulatory capital and reserve creation and approaches to the national system of financial statements, etc.

The National Bank continued to strengthen supervision in the area of an in-depth analysis of performance indicators, early identification of negative trends and crisis situations, and implementation of the entire range of supervisory response measures. Other information on the banks' activities received by the National Bank from controlling bodies as well as in the form of applications made by the citizens and other customers of the banks was also taken into consideration and analyzed.

With a view to improving the quality of the banks' management and protection of the households' deposits, the National Bank was endeavoring to enforce disclosure by the banks of information on the real owners to the supervisory authority and to find out how significant the real impact of the shareholders (promoters) lacking highly reliable ratings on the banks' activities was.

On analyzing submitted reports and other information, the National Bank, in order to suppress negative trends, was issuing directions to the banks requiring them to remedy the revealed violations. Such forms of work with the banks as holding meetings, at the National Bank or on-site, with the executive bodies of the banks that committed violations as well as providing recommendations to the banks' senior management, supervisory boards (boards of directors), and promoters (shareholders) were actively used.

The results of such analysis constituted grounds for the National Bank to take decisions requiring the supervisory boards and other governing bodies of individual banks to ensure the elimination of hazards threatening the interests of depositors and other creditors. In the course of regulation of and supervision over the banks' activity the National Bank applied sanctions thereto.

3.3.2. Bank inspections

The National Bank conducted comprehensive and topical (along individual lines of business) inspections of the banks.

Inspections were preceded by preliminary work in the course of which a list of issues subject to inspection was compiled and, if appropriate, a program for its implementation was developed and approved by the person who made a decision to conduct an inspection.

Pursuant to the current regulations each bank is subject to a comprehensive inspection at least once every three years. Eight comprehensive bank inspections were conducted in 2006, and 14 in 2005.

The program of a comprehensive bank inspection included not only the banking supervision issues but also the issues of organizing money circulation, cash desk operation and money collection, ensuring fail-safe operation of information computation systems, foreign exchange regulation and foreign exchange control, compliance with anti-money laundering laws, and others.

Based on the results of the inspections, statements were drawn which gave an account of violations of legislation governing banking activities as well as opinions that gave assessments of the risks of loss of regulatory capital adequacy, compliance thereof with the operations performed by the bank, the level of major banking risks (credit risk, foreign exchange risk, interest rate risk, operational risk, liquidity risk, and others), the quality of risk management, the quality of assets, and the internal control system, including internal audit functioning. A conclusion regarding the quality of the bank governance was drawn on the basis of the analysis of the assessments made.

In carrying out inspections of the banks that have powers under license to attract households' deposits, an assessment of the quality of assets and credit risk level was of great importance. To this end, the structure of assets, their diversification, the ratio of the actual reserve for potential losses on assets subject to credit risk to the estimated reserve and accuracy of reserve creation, the system of credit risk management as well as the internal control system of the banks were analyzed.

The Banking System Stability Committee reviewed the findings of the inspections and approved sanctions against the banks and recommendations for improving their operation.

3.3.3. Macroprudential supervision

Macroprudential supervision in the Republic of Belarus is aimed at the assessment of the state of the banking sector and its susceptibility to potential shocks. The principal tasks of the National Bank therefore were to monitor banking sector development and analyze and forecast the sustainability of its functioning, including in interrelation with the macroeconomic processes.

Along with the monitoring and analysis of the tendencies in the dynamics of the financial soundness indicators, the key instruments of the macroprudential analysis also comprise the analysis of scenarios, stress testing, and early warning systems. Beginning in 2006, the supervisory agencies of the National Bank have been stress testing the banking sector on a regular basis in an attempt to find out to what extent the banks are able to withstand exceptional—however, likely—destabilizing shocks, which, as a result, makes it possible to identify potentially weak spots of the banking sector requiring special attention. Approaches to the analysis of the main macroeconomic indicators of the emergence and development of instability in the banking sector were developed in 2006. It is expected that in 2007 an econometric forecasting model of a bank crisis employing panel data based on international statistics will be designed and a credit risk macroeconomic model for the banking sector of the Republic of Belarus is scheduled for production.

The Commission for Evaluation of Financial Soundness of the Banking System of the Republic of Belarus (hereinafter – the “Commission”) has been set up at the National Bank for the purpose of carrying out an in-depth analysis of macrofinancial interrelations and regular exchange of information on key macroeconomic conditions of and trends in banking sector development.

In 2006, the Commission held 12 meetings which addressed the issues relating to the monitoring of key trends in the economy and monetary sphere and impact thereof on financial soundness of the banks; the development of methodological approaches to and methods of stress testing; the development of the early warning systems of crisis situations in the banking sector, including those employing economic and mathematical models of analysis and forecasting of the state of the banking sector; the factors behind the

changes in the quality of the banks' credit portfolio; the performance by the National Bank of the functions of the lender of last resort, and others.

3.4. Combating money laundering and terrorism financing

In its endeavors to fight money laundering and financing of terrorism, the National Bank was abiding by the Law of the Republic of Belarus No. 426-3 "On Combating Money Laundering and Terrorism Financing" dated July 19, 2000 (hereinafter – the "Law") (National Register of Legal Acts of the Republic of Belarus, 2000, No. 75, 2/201; 2005, No. 196, 2/1165).

In connection with the enactment of the Law of the Republic of Belarus "On Amending the Law of the Republic of Belarus "On Anti-Money Laundering Measures" dated December 11, 2005 (National Register of Legal Acts of the Republic of Belarus, 2005, No. 196, 2/1165) the National Bank, with a view to implementing key provisions and requirements thereof:

- participated in drafting Resolution of the Council of Ministers of the Republic of Belarus No. 367 "On approval of the design of a special blank form for registration of a financial transaction subject to special control and the Instructions on procedures for filling in, filing, registering, accounting, and storing special blank forms for registration of financial transactions subject to special control" dated March 16, 2006 (National Register of Legal Acts of the Republic of Belarus, 2006, No. 53, 5/22072) and Resolution of the Council of Ministers of the Republic of Belarus No. 336 "On procedures for designating persons engaged in financial transactions in respect of whom information is available about their involvement in terrorism or being under control of persons who are involved in terrorism and bringing the names of these persons to the notice of persons engaged in financial transactions" dated March 11, 2006 (National Register of Legal Acts of the Republic of Belarus, 2006, No. 42, 5/21050);

- drafted the Instructions on organizing internal control at the banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 139 dated September 28, 2006. In line with the requirements laid down in these Instructions internal control must be carried out by the authorized governing body, executive bodies of the bank, its divisions and employees at all levels, including the internal audit function and officers responsible for carrying out internal control, practices and procedures which ensure that the bank will not be involved in illegal financial transactions, among them prevention and suppression of criminal acts relating to money laundering and financing of terrorism;

- issued Recommendations on organizing internal control by the banks (non-bank financial institutions) to combat money laundering and financing of terrorism (letter of the National Bank of the Republic of Belarus No. 21-20/367 dated April 3, 2006). These Recommendations contain requirements for the identification of customers, qualifications and training of the staff, ensuring storage of documents and information confidentiality, as well as criteria for revealing transactions in which the customers of the banks (non-bank financial institutions) may engage for the purpose of laundering money. The banks are advised to pay special attention to such transactions and, if there are grounds for suspicion, notify the Financial Monitoring Department of the State Control Committee of the Republic of Belarus (hereinafter – the “FMD”) accordingly; and

- drafted the Instructions on procedures for suspending individual transactions by the banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 34 dated March 13, 2006 (National Register of Legal Acts of the Republic of Belarus, 2006, No. 42, 8/14114) which regulate the suspension of financial transactions if at least one party thereto is a person involved in terrorism or is under control of persons involved in terrorism.

The regulatory framework for combating money laundering and financing of terrorism is constantly improved taking into consideration international standards, amendments and modifications made to national legislation, as well as experience to date.

The National Bank devised and implemented an appropriate software complex which can be used by the banks for sending information on transactions subject to special control to the FMD and by the FMD for processing such information.

To train banks’ specialists involved in combating money laundering and financing of terrorism, the National Bank, in consort with the FMD, held a series of training seminars on relevant topics.

In the context of international cooperation and sharing experience, the National Bank:

- took part in videoconferences attended by specialists from Belarus, Armenia, Azerbaijan, Georgia, Moldova, and international experts on combating money laundering and financing of terrorism which were organized by the resident office of the World Bank in the Republic of Belarus

in consort with the FMD as well as in the seminar on consultations with the representatives of the banking and insurance sectors held by the Eurasian Group on Combating Money Laundering and Financing of Terrorism (hereinafter – “EAG”);

- exchanges information on legislative regulation in the field of combating money laundering and financing of terrorism with the central banks of foreign states and international organizations; and

- continued to implement the Agreement between the Central Bank of the Russian Federation and the National Bank of the Republic of Belarus on Organization of Information Exchange and Staff Training in the Field of Combating Money Laundering and Financing of Terrorism (Astrakhan, May 20, 2005). The drafts of similar agreements have been sent to the central banks of the EAG member-states for consideration.

At present, the banking system is improving the quality of its approach to revealing and preventing instances of money laundering and financing of terrorism in comparison to the infancy and initial period of development of this activity. It is quite obvious that the tendency towards transition of the banking community from formal compliance with legislative requirements for combating money laundering and financing of terrorism to active work in this sphere has been on the rise.

3.5. Ensuring banks' information transparency

In compliance with the requirements of the supervisory authority, the banks provide legal and natural persons with information on their financial condition, powers under license, the list of their banking operations and other types of activities, and professional level of their managers.

The banks are required to publish in the official republican mass media their audited annual reports as well as quarterly reports.

Taking into account the recommendations made by the Basel Committee on Banking Supervision and in order to enhance transparency of the banks' activities and stimulate market discipline, the regulatory act governing banks' disclosure procedures (the Instructions on procedures for disclosure of information by the banks and non-bank financial institutions approved by Resolution of the Board of the National Bank of the Republic of Belarus No. 6 dated January 19, 2006) was substantially improved.

For the purpose of ensuring information transparency of the banking sector the National Bank publishes in its publication “Bankauski Vesnik” (“Bank Bulletin”) and on the National Bank’s website at www.nbrb.by:

- list of banks issued with banking licenses by the National Bank;
- information on revocation, suspension, or revalidation of banking licenses (including licenses for single banking operations);
- aggregated financial indicators of the banks’ activities;
- annual and quarterly reports provided by the banks for publication;
- other information on the activities of individual banks (with their consent); and
- information (analytical materials, articles, and comments) regarding the National Bank’s activities in the sphere of banking supervision and development and implementation of the regulatory legal acts governing the banks’ activities.

The National Bank publishes, with the banks’ consent, certain financial data about the banks in its monthly compilation “Bulletin of Banking Statistics” (www.nbrb.by/statistics/bulletin).

Most Belarusian banks have own websites on which they publish information subject to mandatory disclosure as well as additional information (Attachment 1).

3.6. Cooperation with international financial institutions and supervisory authorities of other countries

The National Bank aims to expand and strengthen international professional contacts in the sphere of banking supervision, to raise awareness of the foreign banking community of the banking system of Belarus, which is conducive to promoting investment and business attractiveness of the Belarusian banking system.

3.6.1. Cooperation with the IMF

The Republic of Belarus has been cooperating with the IMF since 1992 when the country joined this international financial institution. With the IMF's assistance a modern banking supervision system has been set up and is in place.

In January 2006, the IMF and the World Bank presented, as part of the financial sector assessment program of the Republic of Belarus (the 2004 mission), updated technical notes containing an assessment of stability of the Belarusian financial sector under the FSAP in the context of which, in particular, compliance of Belarusian banking supervision with the Core Principles for Effective Banking Supervision, transparency of monetary policy and banking supervision, and stress testing of the banks were assessed. In 2007, it is planned to make a self-assessment of compliance with the revised version of the Basel Committee's Core Principles for the Effective Banking Supervision having regard to the arrangements made in the sphere of supervision development.

In February 2006, the National Bank was visited by the IMF technical assistance mission which focused on the examination of the progress of compliance with the recommendations of the previous mission (April 2005), provision of assistance in finalizing draft recommendations on inspections, and provision of recommendations on ways of implementing consolidated supervision in the Republic of Belarus. The mission was tackling such issues as methods of conducting inspections, consolidated supervision, stress testing, macroprudential supervision, international agreements on supervision and licensing, and requirements for business and ethics qualities.

3.6.2. Cooperation with the Group of Banking Supervisors from Central and Eastern Europe (BSCEE Group)

Beginning in 1966, the National Bank has been a member of the BSCEE Group (<http://www.bscee.org>), a regional entity of the Basel Committee on Banking Supervision.

Within the Group, its members share experience regarding regulation of and supervision over the development of the national banking systems and hold, on an annual basis, conferences for the heads of the national supervisory authorities. Also, several seminars have been organized. A

compilation containing information about the banking systems of the Group member-states is published. The National Bank takes part in all these events.

The representatives of the Banking Supervision Directorate participated in the XIXth Annual Conference of the BSCEE Group which was held in April 2006 in Montenegro. The participants from the BSCEE Group member-countries attended the Conference.

Main aspects of the New Basel Capital Accord (Basel II): the third pillar “Market discipline”, as well as issues of the banks’ corporate governance were discussed in the course of the Conference.

3.6.3. Cooperation with supervisory agencies of other countries

The National Bank is endeavoring to establish and develop contacts and information exchange with foreign banking supervisory authorities.

By the end of 2006, nine bilateral agreements with foreign banking supervisory agencies were in force, chiefly from the CIS member-states and Baltic countries.

In November 2006, the work aimed at harmonizing regulations laid down in draft Memorandum of Understanding between the Financial Market Regulation and Supervision Agency of the Republic of Kazakhstan and the National Bank of the Republic of Belarus in the Sphere of Banking Supervision (hereinafter – the “Memorandum”) with the Banking Code and other legal acts of the Republic of Belarus was carried out. Recommendations and comments on draft Memorandum were sent to the Agency of the Republic of Kazakhstan.

At the meetings of the Advisory Board of the central banks of the Republic of Belarus and Ukraine decision was made (Minutes No. 5 of November 22, 2006) to sign in the first half of 2007 the revised version of the Agreement between the National Bank of the Republic of Belarus and the National Bank of Ukraine on cooperation in the field of supervision over activities of credit institutions in order to bring it in line with applicable legislation of the Republic of Belarus and Ukraine in the field of banking supervision regulation.

With a view to expanding the exchange of information, the work designed to sign the Memorandum of Understanding in the field of banking supervision with the China Banking Regulation Commission is going on.

3.7. The outlook for banking supervision development

Further improvements in banking supervision will be ensured in the areas defined by the policy documents concerning development of monetary policy and banking sector of the Republic of Belarus and by corresponding plans of actions of the Government and the National Bank based on the need for bringing it as close as possible to the international standards. Among the main areas of banking supervision development in 2007 are the following:

1. development of banking supervision forms and methods such as:

- developing banking supervision on a consolidated basis, formation of the system of secure functioning requirements for bank groups and bank holding companies;

- improving the methods of analysis of the banks' financial condition;

- improving the approaches to the procedures and methods of inspecting the banks and non-bank financial institutions under risk-oriented supervision; and

- establishing a single fund of supervisory and checking information about the banks and non-bank financial institutions;

2. improvements in the complex of instruments and methods of macroprudential analysis (stress testing, scenarios and early warning system analysis) such as:

- developing an information data base which comprises time-series data of the banking sector soundness and macroeconomic indicators and developing methods and procedures for their regular compilation;

- establishing a system for monitoring the financial soundness indicators;

- developing the structure of and compiling periodic brief analytical review on the soundness of banking sector functioning;

- improving the algorithms and scenarios of banking sector stress tests which are conducted periodically; and

- developing a model for stress testing the banking sector;

3. modernization of the inspections practices relating to the provision of a comprehensive assessment of governance efficiency and functioning of the banks, prevention of negative phenomena in their activities, and application of adequate supervisory response measures which is based on the improvement of correspondent inspection regulations.

The realization of the above measures is conducive to maintaining banking sector efficiency at an adequate level in a changing banking environment where the functioning of the banks is required to meet the needs of social and economic development of the country.

References to Sites of Banks of the Republic of Belarus

1. Open Joint–Stock Company "Belagroprombank": <http://www.belapb.by>
2. Joint–Stock Company "Savings Bank "Belarusbank":
<http://www.belarusbank.minsk.by>
3. "Priorbank" Open Joint–Stock Company: <http://www.priorbank.by>
4. Open Joint–Stock Company "Belpromstroibank": <http://www.bpsb.by>
5. "Belarussian bank of development and reconstruction "Belinvestbank" Open Joint– Stock Company: <http://www.belinvestbank.by>
6. Open Joint–Stock Company "BELVNESHECONOMBANK":
<http://www.bveb.by>
7. Unitary Enterprise "Foreign Bank "Moscow–Minsk":
<http://www.mmbank.by>
8. "Belorussian–Russian "Belgazprombank" Open Joint–Stock Company:
<http://www.belgazprombank.by>
9. "Slavneftebank" Closed Joint–Stock Company: <http://www.snbank.by>
10. Closed Joint–Stock Company "Trustbank": <http://www.trustbank.by>
11. Closed Joint–Stock Company "Minsk Transit Bank": <http://www.mtb.by>
12. Open Joint–Stock Company "Technobank": <http://www.tb.by>
13. Closed Joint–Stock Company "BELROSBANK"
<http://www.belrosbank.by>
14. Open Joint–Stock Company "Belarussian Industrial Bank":
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15. Closed Joint–Stock Company "Absolutbank": <http://www.absolutbank.by>
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17. Closed Joint–Stock Company "SOMBelBank":
<http://www.sombelbank.by>
18. Closed Joint–Stock Bank of Reconversion and Development
<http://www.rrb.by>
19. Closed Joint–Stock Company "Byelorussian–Swiss Bank":
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<http://www.bnb.by>
21. Open Joint–Stock Company "Paritetbank": <http://www.paritetbank.by>
22. Closed Joint–Stock Company "ATOM–BANK":
<http://www.atombank.by>
23. Open Joint–Stock Company "International reserve bank":
<http://www.irb.by>
24. Joint Stock Company "International Trade and Investement":
<http://www.itibank.by>

25. Joint Stock Company “ASTANAEXIMBANK”: <http://www.aeb.by>
26. Belarusian Banks Association: <http://www.abbanks.by>
27. BELARUSIAN CURRENCY AND STOCK EXCHANGE:
<http://www.bcse.by>

Statistical Attachment

Table 1

Number of Banks

Type of financial institutions	2000	2001	2002	2003	2004	2005	2006
Operating banks	28	25	28	30	32	30	30

Table 2

Structure of Banks' Total Registered Authorized Capital Broken Down by Investors' Form of Ownership

Investor's form of ownership	2004	2005	2006
Investments of residents of the Republic of Belarus,	88.21 %	90.70 %	92.16 %
including public authorities and state-owned legal persons	81.90 %	85.30 %	87.92 %
Foreign investment	11.79 %	9.30 %	7.84 %
Total investment	100.00 %	100.00 %	100.00 %

Table 3

Banks' Assets Distribution

Three biggest banks			Five biggest banks			Four state-owned banks		
2004	2005	2006	2004	2005	2006	2004	2005	2006
69.20 %	68.25 %	71.20 %	84.29 %	83.63 %	86.71 %	69.87 %	74.43 %	78.59 %

Distribution of Market Shares (in Gross Assets) by Groups of Banks
(banks are grouped by the size of regulatory capital)

	2004		2005		2006	
	Share	Banks	Share	Banks	Share	Banks
Banks' regulatory capital,	100.00 %	31	100.00 %	30	100.00 %	29
of which:						
negative capital	0.31 %	1	0.00 %	0	0.28 %	1
up to BYR10 billion	1.03 %	7	0.62 %	6	0.10 %	4
BYR10 billion to BYR30 billion	5.89 %	13	3.77 %	11	1.34 %	7
BYR30 billion to BYR70 billion	6.66 %	4	8.10 %	7	7.60 %	10
BYR70 billion to BYR500 billion	31.48 %	4	28.47 %	4	27.69 %	5
BYR500 billion to BYR1 trillion	40.69 %	1	0.00 %	0	0.00 %	0
over BYR1 trillion	13.94 %	1	59.04 %	2	62.99 %	2

Table 5

Structure of Assets and Liabilities of the Banking System

	2004	2005	2006
Assets			
1 Cash and precious metals	2.7 %	2.5 %	2.5 %
2 Funds with the National Bank	2.0 %	3.4 %	1.8 %
3 Funds with other banks	9.8 %	9.3 %	5.2 %
4 Funds on the account in the Required Reserves Fund with the National Bank	4.4 %	3.9 %	4.5 %
5 Investments in securities	6.9 %	10.0 %	8.7 %
6 Credit debt of legal and natural persons	67.8 %	64.7 %	72.0 %
7 Fixed and intangible assets	5.0 %	4.6 %	3.6 %
8 Other assets	1.4 %	1.6 %	1.7 %
Total assets	100.0 %	100.0 %	100.0 %
Liabilities			
1 Regulatory capital	20.1 %	19.7 %	17.8 %
2 Settlement and current accounts balances	14.5 %	15.5 %	12.8 %
3 Funds on correspondent accounts with other banks	1.2 %	0.7 %	0.5 %
4 Deposits and credit resources of other banks	10.0 %	7.7 %	11.8 %
5 Deposits of legal and natural persons	43.7 %	45.1 %	47.6 %
6 Credit resources of the National Bank	3.2 %	3.5 %	5.3 %
7 Other liabilities	7.3 %	7.8 %	4.2 %
Total liabilities	100.0 %	100.0 %	100.0 %

Table 9

Structure of Credits by Form of Client's Activities

	2004	2005	2006
Credits distribution by industries	100.0 %	100.0 %	100.0 %
Industry	35.9 %	29.7 %	27.3 %
Agriculture	12.6 %	13.4 %	14.6 %
Trade	7.2 %	7.3 %	7.7 %
Construction	2.1 %	2.0 %	2.2 %
Households	21.2 %	26.3 %	27.8 %
Other	21.0 %	21.4 %	20.4 %

Table 10

Structure of Credits and Deposits by Maturities

Types of deposits	2004	2005	2006	Types of credits	2004	2005	2006
Demand deposits	44.64 %	46.04 %	44.59 %	Long-term credits	47.94 %	51.43 %	54.01 %
Time deposits	55.36 %	53.96 %	55.41 %	Short-term credits	52.06 %	48.57 %	45.99 %
Total	100.00 %	100.00 %	100.00 %	Total	100.00 %	100.00 %	100.00 %

Table 11

Structure of Banks' Income and Expenses

		BYR bln		
		2004	2005	2006
Income				
1	Interest income	1,338.0	1,564.0	2,082.4
2	Commission income	501.7	684.0	878.3
3	Other banking income	208.6	219.4	313.0
4	Other operating income	143.6	137.1	92.6
5	Changes in reserves	69.7	96.2	109.7
6	Incidental income	0.1	0.1	–
	Total	2,261.8	2,700.8	3,476.0
Expenses				
1	Interest expenses	742.1	869.6	1,195.6
2	Commission expenses	42.8	55.3	102.7
3	Other banking expenses	48.6	16.8	33.5
4	Other operating expenses	1,127.7	1,337.3	1,515.8
5	Transfers to reserves	119.9	211.2	208.4
6	Incidental expenses	0.0	0.0	0.0
	Total	2,081.2	2,490.2	3,056.0
	Economic profit	180.7	210.6	420.0

Regulatory Capital Structure

		BYR bln		
		2004	2005	2006
	Total regulatory capital (pp 1+4-5+6)	2,895.6	4,021.3	5,150.2
1.	Fixed assets, total,	2,389.2	3,274.7	4,162.3
	of which:			
	<u>Items that increase fixed assets</u>			
1.1.	Registered authorized capital	2,159.6	2,941.5	3,731.6
1.2.	Differences of money issue	0.0	0.0	0.0
1.3.	Bank's funds and profit for the previous years	239.4	378.4	534.6
1.4.	Unrealized exchange rate differences and revaluation of foreign exchange in the funds	32.8	-4.8	2.4
	<u>Items that decrease fixed assets</u>			
1.5.	Repurchased own shares	11.6	1.6	1.5
1.6.	Loss for the year under account and previous years	17.2	14.0	30.8
1.7.	Intangible assets	4.3	6.9	20.7
1.8.	Investments in affiliates	8.8	16.7	51.2
1.9.	Shareholdings (20% and more of the legal person's authorized capital)	0.7	1.0	2.1
2.	Additional Tier II capital, total,	622.3	795.8	990.0
	of which:			
2.1.	Profit for the year under account and previous years with account of its distribution	104.2	205.3	413.7
2.2.	Funds created at the expense of profit not confirmed by external auditors	57.6	19.6	9.1
2.3.	Unrealized exchange rate differences from revaluation of foreign exchange in the funds	1.4	0.2	0.0
2.4.	Revaluation of fixed assets and other items of the balance	421.5	526.4	526.9
2.5.	Attracted long-term subordinated credit which is taken into account	37.6	44.3	40.3
3.	Additional Tier III capital, total		0.0	0.0
4.	Additional Tier II and Tier III capital included in regulatory capital	606.5	795.8	987.6
5.	Items that decrease regulatory capital, total,	118.3	49.2	10.3
	of which:			
5.1.	Underestablished reserve to cover possible losses on assets subject to credit risk	117.9	43.3	1.3
5.2.	Issued credits		5.9	9.0
5.3.	Excess of the aggregate amount of risks by insiders over its maximum value	0.4	0.0	0.0
5.4.	Investments in affiliates		0.0	0.0
5.5.	Shareholdings (20% and more of the legal person's authorized capital)		0.0	0.0
6.	Negative regulatory capital	18.2	0.0	10.6

Macprudential Indicators of Belarusian Banking Sector Activities

	Description	01.01.2006	01.04.2006	01.07.2006	01.10.2006	01.01.2007
	Capital adequacy					
1	Regulatory capital/risk-weighted assets ratio	26.66 %	25.54 %	23.67 %	21.99 %	24.39 %
2	Fixed capital/risk-weighted assets ratio	18.75 %	18.16 %	16.80 %	15.36 %	17.37 %
	Assets quality					
3	Share of problem debt in total credit debt	1.88 %	1.54 %	1.44 %	1.36 %	1.16 %
4	Assets risk ratio (assets subject to credit risk minus estimated reserve/assets subject to credit risk)	98.21 %	98.12 %	98.29 %	98.55 %	98.54 %
5	Problem assets minus actually established reserve to cover them/regulatory capital ratio	6.29 %	7.21 %	6.91 %	5.54 %	6.12 %
6	Clients' and banks' problem credit debt; problem off-balance debt; and clients' and banks' overdue and not received income in the aggregate/clients' and banks' credit debt	4.54 %	3.98 %	3.65 %	3.30 %	2.86 %
7	Completeness of establishment of special reserve to cover possible losses on assets subject to credit risk (actual reserve/estimated reserve)	84.58 %	87.41 %	96.96 %	99.54 %	99.70 %
8	Aggregated big credit risks/regulatory capital ratio	58.04 %	49.76 %	54.90 %	63.91 %	61.63 %
9	Clients' credit debt in foreign exchange/clients' aggregated credit debt	38.54 %	37.28 %	34.62 %	34.53 %	35.40 %
	Income and Profit					
10	Return on assets (ROA)	1.25 %	0.35 %	0.81 %	1.30 %	1.70 %
11	Return on equity (ROE)	6.75 %	1.82 %	4.29 %	7.19 %	9.55 %
12	Interest margin/gross income	25.71 %	25.04 %	25.91 %	25.74 %	25.51 %
13	Interest margin/income-earning assets	3.87 %	1.07 %	2.06 %	2.77 %	3.45 %
14	Non-interest expenses/gross income	60.00 %	58.46 %	56.68 %	55.11 %	53.52 %
	Liquidity					
15	Liquid assets/total assets ratio	30.36 %	25.42 %	23.93 %	23.68 %	24.11 %
16	Actual liquidity/required liquidity ratio (short-term liquidity)	1.39	1.28	1.15	1.01	1.44
17	Demand assets/demand liabilities ratio (instantaneous liquidity)	117.76 %	138.68 %	116.74 %	133.74 %	129.01 %
18	Current assets/current liabilities ratio (current liquidity)	95.92 %	108.74 %	98.84 %	107.64 %	96.74 %
19	Clients' deposits/clients' credit debt ratio	68.70 %	66.71 %	66.52 %	66.55 %	65.18 %
	Indicators of Management Quality					
20	Gross incomes/gross expenses	108.46 %	110.75 %	112.38 %	112.46 %	113.75 %
21	Staff costs/non-interest expenses	26.11 %	31.04 %	30.26 %	31.19 %	30.47 %
22	Gross incomes per worker on payroll, on average, BYR million	58.2	16.3	33.9	51.6	72.8